UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16293

In the Matter of

LAURIE BEBO, and
JOHN BUONO, CPA

Respondents.

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RESPONDENT LAURIE BEBO'S REPLY BRIEF IN SUPPORT OF HER APPEAL TO THE COMMISSION

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INTRODUCTION

For the fourth time, the Division has repeated the same pre-determined narrative and "facts"—the same factual exposition set forth in its pre-hearing brief, its post-hearing brief, and its post-hearing reply brief. Because the Division's theory of liability was a pre-determined one, any facts that do not fit the narrative surrounding that theory—whether in the form of documents, testimony of its own witnesses, or statements made by witnesses like John Buono to the Division in hours of interview sessions—are simply ignored or obfuscated.

As much as the Division would like to frame this case as Bebo's testimony on one side of the scale and all other testimony and documentary evidence on the other side, this is simply not the truth. Indeed, Bebo's opening brief is based largely on documents, testimony, and prior statements of other witnesses.

The ALJ assigned to hear Bebo's case had no inclination to challenge the Division's flawed assertions, and even engaged in similar improper analysis as detailed in Bebo's petition for review.[1] Respondent must trust, however, that the Commission will take the time to review the entire record, including Respondent's post-hearing briefsw that cite with particularity the inaccuracies of the Division's narrative. As the Division asserted in its motion to strike Bebo's offer of proof, her lengthy briefs that chronicle the careless treatment of the record and stretching of the evidence beyond the breaking point are part of the record for this Commission's consideration with respect to Bebo's appeal. Space limitations prohibit a point-by-point rebuttal beyond what was already itemized in the post-hearing briefing and the petition for review.

By way of example only, the Division falsely states that Bebo's February 19, 2009 email to Ventas proposing ALC purchase two New Mexico properties also requested not only

[1] As noted in Bebo's opening brief, this is not the first time that this ALJ's demeanor and impartiality have been questioned. The January 21, 2016, Office of Inspector General report about ALJ bias amplifies those concerns rather than dispels them.

modifications to the coverage ration covenants but eliminating the occupancy covenants entirely. (Div.Br. 20)[2] Every witness, including the Division's Ventas witnesses, testified that the proposal did not request occupancy covenant relief. (Tr. 354-55, 432.) Division witness Buono testified that the occupancy covenants were specifically not addressed because ***Bebo believed that the occupancy covenant would be easily satisfied by including employees in the covenant calculations.*** (Tr. 2359-60, 2500-01, 2504-05.) Incredibly, this is not the first time Bebo has pointed out the falsity of this particular Division statement. The Division has repeated the same statement in its earlier briefs. The position was even rejected by the Initial Decision (at 23), with the quotation to the testimony cited by Bebo in the briefing.

Presumably the reason the Division resorts to these tactics is it never conformed a legal theory to the facts, and attempted to prove a breach of contract case rather than securities fraud. As a result, one gaping hole in the Division's case is materiality. Nothing submitted by the Division at the hearing or in briefing fills that hole.

Further, the Division ignores facts related to ALC's deliberative process that led to the opinion in its Commission filings that it complied with "certain operating and occupancy covenants." This is telling of the Division's inability to meet the burden of proving a securities fraud claim here. Literally more than a dozen people between 2009 and early 2013, who had roles in evaluating or approving ALC's periodic filings and the challenged statement at issue here, were aware of the basic fact that ALC was meeting the financial covenants through the use of rooms that the Company paid for employees to use. This included people internal at ALC (including its Disclosure Committee), at GT, at Quarles & Brady, and at Milbank. *None of them*

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[2] The Division's opposition brief in this appeal is cited as "Div.Br. __." Bebo's opening brief in this appeal is cited as "Br. __." Bebo cites the record herein in the same manner as her opening brief and continues with the same defined terms established in her opening brief (*e.g.* the "Solari Email," the "Solari Call," etcetera).

ever suggested that ALC needed to disclose the manner in which it was meeting the Lease covenants or its disclosure misrepresented compliance.

The Division's mistaken position that the employee-leasing arrangement was inherently impermissible because there was no formal modification of the Lease dooms the Division's disclosure claim, particularly where a challenged compliance opinion must be *unreasonable*, not just wrong in hindsight.[3]

In addition to many other evidentiary voids to support a theory of liability, this case has substantial constitutional infirmities, both facially—affecting the permissibility of these proceedings in their totality—and procedurally by, among other things, depriving Bebo the ability to call or cross-examine two Canadian witnesses who are central to the OIP allegations. This violation of procedural due process was compounded when the ALJ read the investigative testimony transcripts of both witnesses—testimony taken after Bebo was provided a Wells notice so the Division could lock in its potential direct examination—*before the trial started.* (*See* Tr. 10-11, 106-07.)

The Commission now has the opportunity and the obligation to review these facts anew, and demonstrate that respondents can receive a fair trial in the administrative process. For the reasons set forth herein and in Bebo's opening brief, the Initial Decision should be reversed.

[3] The Division falsely states "Bebo insists on referring to both practices [(a) employees staying at Ventas facilities as part of a taskforce versus (b) including employees in the covenant calculations] as 'employee leasing.'" (Div.Br. 11 n.5 citing Br. 2 n.2.) Bebo's brief specifically defines the term solely with respect to employees and the few situations where non-employees were included in the covenant calculations.

ARGUMENT

I. The Division's Response Brief Provides No Support For A Finding Of Materiality.

A. The Division's Attempts To Negate Smith's Event Study Analysis Is Legally Foreclosed.

In its opposition, the Division concedes, as it must, that analyzing ALC's share price reaction in response to a curative disclosure through the use of an event study conducted by an expert is highly probative, if not dispositive, of the materiality requirement. However, the Division continues to put forth the same flawed analysis focusing on the decline in ALC's share price on a different day, May 4th. As discussed in Bebo's opening brief, the focus on May 4th is flawed under the circumstances. On May 3, 2012, just before the market closed, ALC issued a one-line press release that it would delay its Q1 2012 earnings announcement and conference call with analysts. (Exs. 2081, 2186 at 18.) This course was opposed by Bebo because it potentially misled investors about the reason for the earnings delay.[4] (Br. 40.) ALC's stock shot up 8.31% in the last seven minutes of trading on May 3rd because it was well-established in the market that ALC was trying to sell the company. (Ex. 2186 at 18 n.59; 2130; Tr. 4495.)

The following morning, ALC disclosed: (1) it had not postponed its earnings release because there was good news about the sale of the company; (2) the Ventas lawsuit related to alleged defaults for regulatory violations; and (3) that ALC's Board had decided "to investigate possible irregularities in connection with the Company's lease with Ventas." (Ex. 2075.)

[4] The Division also continues to assert that the notes Bebo took on May 3-4 reflecting these concerns support a finding of materiality. (Div.Br. 45.) They do not. The notes indisputably refer to the fact that ALC was facing an uncurable default as a result of the regulatory violations and was facing the prospect of having the facilities shut down. Through its misleading quotation of the notes, the Division conflates the Ventas lawsuit based on the licensing revocation issues with a potential default under the financial covenants. The only testimony on this topic establishes that the notes refer to the lawsuit and license revocation problems, which ALC's outside counsel determined were insurmountable in the litigation. (Tr. 2229; Ex. 1051.) As Smith explained, conflating the two types of defaults for purposes of assessing the potential financial impact on a company is "a bait and switch." (Tr. 3662-63.)

The Division seems to adopt the ALJ's flawed contention that the third component of the May 4th disclosure caused the ALC share price decline on May 4th. (Div.Br. 54.) However, as established in Bebo's opening brief, the disclosure of an internal investigation—particularly where, as here, the disclosure of the investigation did not tie the investigation in any way to any financial covenant allegations—does not constitute a corrective or curative disclosure for purposes of evaluating share price movement for an event study. (Br. 6, 11.) The Division's only response to this argument is the assertion that the cases Bebo cites apply event studies in private securities litigation where loss causation as well as materiality is a component of the claim. (Div.Br. 52 n.29.)

The Division's argument has been rejected in the past for the nonsense that it is. In *United States v. Schiff*, 538 F.Supp.2d 818 (D.N.J. 2008) *aff'd* 602 F.3d 152 (3d Cir. 2010), the court confronted this same argument from the government in a criminal securities fraud case. Like the Division here, the government argued in *Schiff* the failure of its expert to parse out the causal nexis of the curative disclosure to a particular part of the share price decline did not matter because "it was not required to prove loss causation and thus was not required to disaggregate potential causes of the observed price drops" because "reliance and loss causation are not elements of a [government action]." *Id.* at 838.

Rejecting this argument, the court reasoned that the government's position "fundamentally misses the most basic logic for stock price drop evidence to be relevant in the first place." *Id.* Moreover, the court continued, "[w]ithout a causal link to the curative disclosure of the misstatement charged in the indictment, evidence of a stock price drop is not probative of the materiality of that alleged misstatement, and instead is more prejudicial or confusing than probative." *Id.* Affirming the district court, the Second Circuit quoted the above language and credited the "comprehensive" analysis by the district court. *Schiff*, 602 F.3d at 173, 175-76 n.33. Without demonstrating that the prior misrepresentation *caused* the stock drop, the Second Circuit reasoned the fact-finder would be left to only "speculate" with respect to materiality. *Id.* at 177.

In the same case, the government sought to preclude the defendant's financial economist who opined that the disclosures at issue did not constitute corrective disclosures or that the other bad news unrelated to information curing the prior misrepresentation caused the observed share price decline. The government again asserted that causation was not relevant. Again, the district court rebuked the government, reasoning that the argument "turns on its head the purpose of stock price drop evidence and demonstrates the fundamental misunderstanding of the relevance of stock price drop evidence that permeates the Government's briefing." *Id.* at 843.

The issue here is exactly the same as the issue addressed by the "corrective disclosure" cases discussed in Bebo's opening brief and in *Schiff*. Like the government's position in *Schiff*, the Division's position in this case fundamentally misses the basic logic for stock price drop evidence to be relevant in the first place. The share price decline on May 4th is irrelevant because it was not caused by any disclosure curing or correcting the charged misrepresentation. There was no *public* indication that the May 4th disclosure of an investigation into "irregularities" in connection with the Lease related to financial covenant allegations in any way. *See Schiff*, 538 F.Supp.2d at 835, 836 (emphasizing "it must be demonstrated that public disclosure of the misstatements charged in the indictment had an appreciable negative effect on the share price" and that "facially unrelated adverse events" disclosed must be eliminated from the analysis.). Furthermore, it is undisputed that the stock analysts covering the ALC stock for investors and the industry press all tied the "irregularities" to the patient care and safety issues alleged in the Ventas lawsuit.

B. The ALJ's And Division's Attempt To Provide Their Own Expert Testimony Is Legally Foreclosed.

Recognizing the significance of Smith's analysis and its failure to produce a financial economist expert in rebuttal to Smith's report, the Division promotes the ALJ's own attempt to conduct an unqualified and improper "expert" analysis of ALC's share price movements. Both the Division and the ALJ contend that they can disentangle the second and third components of the news disclosed to the market—the Ventas lawsuit and the internal investigation—from the share price decline caused by the failure of anticipated good news about a merger to materialize. Demonstrating they cannot, they assert different positions and conclusions. (Dec. 61; Div.Br. 54 & n.31.)

These attempts to disaggregate the different factors related to the share price decline on May 4th are improper as a matter of law. *Schiff* again is instructive. There the government initially sought to admit evidence of a stock drop to support its materiality argument without any expert testimony. 538 F.Supp.2d at 834. The district court rejected this because it was "concerned that without an expert analysis of why the stock price dropped, the jury might improperly speculate that the stock price drop was a result of the criminal conduct charged in the case rather than other potential explanatory factors where multiple adverse events coincided temporally." *Id.* In requiring the government to provide an expert to assess different negative factors disclosed at the same time, the court held that "the reason for the use of expert testimony in this context is clear: the formulas for calculating the reaction of the market to specific disclosures are complicated and not common sense observations that could be left to the jury." *Id.* at 835.

The same reasoning applies to the lay-person fact-finder and the Division in this case. As in *Schiff*, their flawed analysis and parsing of the stock drop on May 4th was an improper, speculative attempt to act as experts without any qualifying knowledge, experience or training. This was particularly improper because Smith provided detailed expert testimony that contradicts their positions.

Smith explained his analysis of the various factors comprising the share price decline on May 4th (none of which contain financial covenant allegations). Smith explained there was a "big bump" in ALC's share price on May 3rd because "when the company announced that they were suspending their earnings announcement, the market understood that they were -- the reason they were suspending is because they had news, and the market believed this to be really good news" of an anticipated sale or merger announcement. (Tr. 3639-40.) Thus, Smith concluded, based on his extensive research in this area, that most of the decline on May 4th, and possibly all of it, was the result of over-shoot:

> [M]y experience with the literature on how stock price reactions -- or how stock prices move around merger rumors is that once the likelihood of a merger declines, the stock price will decline further.
>
> So a lot of the -- a substantial part of the stock price movement we see on May 4th is because of the disappointment in what investors thought was going to happen the day before sent stock prices up eight percent; didn't transpire.

(Tr. 3640-41; *see also* 3644 (stating price likely declined substantially more than it had increased the day before simply because the anticipated merger did not materialize.)

Smith acknowledged that "disentangling the other pieces is hard" and he did not do that because none of them told investors any information about ALC meeting the financial covenants through the use of employees. (Tr. 3644.) This was clearly disclosed for the first time on May 14th. (*Id.*) Consequently, Smith could not conclude there was a basis to believe that either the disclosure of the Ventas lawsuit or the disclosure of the internal investigation (or even a combination of the two) caused any statistically significant decline in ALC's share price. (*See* Tr. 3647-48.)

C. The Division's Other Materiality Evidence Is Weak, And Fails To Overcome Smith's Event Study Analysis.

Because this evidence demonstrates the charged misstatements were not material, the Division attempts to relegate event-study-evidence to just another factor to be considered. (Div.Br. 52.) Many courts have determined that this evidence is dispositive of the materiality analysis. (Br. 6.)[5] Other courts recognize that, even if not dispositive, evidence of this type is most probative. For example, the Seventh Circuit stated that although Section 10(b) and Rule 10b-5 do not "foreclose" the possibility that investors will deem information that does not affect the price of a security material, "[u]sually price (or factors that influence price) is all that matters to securities transactions." *SEC v. Jakubowski*, 150 F.3d 675, 681 (7th Cir. 1998); *see also SEC v. Bauer*, 723 F.3d 758, 770 n.3 (7th Cir. 2013).

Other evidence that courts typically consider probative of materiality is testimony from actual investors or analysts covering the stock for investors. *See Flannery v. SEC*, 2015 WL 812647, *8 (1st Cir. Dec. 8, 2015) (finding it highly relevant that investors never asked questions about alleged false or misleading statement). As set forth in her opening brief (at 5), this type of evidence is *totally missing*. The Division's other purported "evidence" related to materiality is simply insufficient to meet its burden in light of the highly probative evidence provided by Smith and his expert analysis.

[5] *See also Shaw v. Digital Equipment Corp.*, 82 F.3d 1194, 1218 (1st Cir. 1996).

1. This Case Does Not Involve Any Accounting Misstatements, And So The Division's Reliance On An Accounting Standard And Auditing Expert Has No Probative Value.

Neither the Division nor the ALJ had identified any case where accounting standards on materiality were applied to a case that did not involve accounting misstatements or GAAP violations. (Br. 13-14.) In its response, the Division was still unable to identify a single case where SAB 99 or any other accounting principle utilized by the Division's expert was applied in a case that did not involve accounting misstatements. The cases the Division cites involve misstated financials and GAAP violations (Div.Br. 52), yet here the Division and its expert concede that ALC's financial statements were not misstated and complied with GAAP. (Tr. 1629, 1634.)

The Division's reliance on its auditing expert, Barron, is similarly misplaced. Moreover, as set forth in Bebo's opening brief (at 13-14), it was established at trial through cross-examination that Barron's opinion rested upon the assumption that every event of default would automatically result in a worst-case scenario under the Lease—a patently false proposition, as explained by the Division's own witness from Quarles & Brady. (Tr. 2298-99).

The Division failed to respond to this argument and the Seventh Circuit precedent cited in Bebo's opening brief establishing that the failure to prove the presumption upon which an opinion is based causes it to be unreliable and should result in it being accorded no weight. Consequently, the Division, as a practical matter, has waived this argument and conceded the error. *Law v. Medco Research, Inc.*, 113 F.3d 781, 787 (7th Cir. 1997); *Beazer E., Inc. v. Mead Corp.*, 412 F.3d 429, 437 n.11 (3d Cir. 2005).

2. The Division's Assertion Of Importance ALC's Board Attributed To The Financial Covenants Is Based On Distortions Of The Record And Has Been Waived.

Next, the Division asserts that ALC management devoted a "section" of its powerpoint presentation for board meetings to covenant compliance and that the Board members, who were also shareholders, purportedly inquired about covenant compliance. (Div.Br. 53-54.) The mere fact that Lease covenants may have been discussed at Board meetings does not support a finding of materiality, and the caselaw cited in the Division's response provides no support for such a claim.[6] And it is facially ridiculous, as it would necessarily support the conclusion that any information contained in a management powerpoint presentation or discussed during board meetings, no matter how trivial, would be material for securities fraud purposes.

Furthermore, the fact management included one slide of a presentation that consisted generally of over eighty slides does not support a finding of materiality (*see, e.g.,* Exs. 81 at 54, 86 at 46), but just the opposite. And far from board members "repeatedly inquir[ing] about ALC's financial covenant compliance" (Div.Br. 54), the Division refers to one board meeting *in 2008*, the February 2009 board meeting *where Buono confirmed that the Board approved employee-leasing* (Br. 38), and an August 2009 board meeting where the minutes refer to no discussion of the Lease covenants—management presented on efforts to increase the occupancy and profitability of the Ventas facilities—and reflect no inquiries made by the board.

Indeed, members of the Audit Committee shockingly testified that they never reviewed the detailed financial information about the Ventas facilities contained in the facility-by-facility information that ALC management provided prior to Board meetings. (Tr. 1369, 2566, 2820-21.) The board packages contained two sets of numbers for the Ventas facilities so the Board

[6] The case principally relied upon by the Division, *SEC v. Mayhew*, 121 F.3d 44 (2d Cir. 1997), is an insider trading case and stands for the unremarkable proposition that an inference may be drawn that non-public information possessed by the defendant was material if he bought or sold stock based on it.

could easily compare those facilities performance to the other ALC properties and the relative performance of the properties with and without the room rentals related to employees. (Tr. 3141; Ex. 2117 at 2; Ex. 293 at 17, Ex. 293A, Ex.81 at 23-26, 54, Ex. 86 at 63-66, 83.)

Finally, the Division continues making the desperate and unsupportable claim that materiality is supported by Buntain's testimony that compliance with financial covenants was "important to him as an investor." (Div.Br. 54.) In one of the handful of findings that was unfavorable to the Division, the ALJ stated this had no bearing on materiality. (Dec. 63.) The Division's failure to file a cross-petition for review pursuant to Rule 410(b) constitutes a waiver of this argument challenging the ALJ's finding. *See In re Ross Mandell,* Release Nos. 34-71668, 71668, 2014 WL 907416, at *1 n.6 (Mar. 7, 2014); Rule 411(d).

It is also meritless. As established at the hearing, the Division procured and Buntain provided a false declaration stating he had exercised stock options and would have wanted to know more information about ALC's compliance with the Lease covenants when he did so. (Tr. 1437-40.) He admitted at trial that he never exercised those options, a fact available to the Division by reviewing Form-4s previously filed by Buntain with the Commission itself. (*Id.*) The Division's continued reliance on Buntain's supposed belief that financial covenant compliance was "important to him as an investor" (which is inextricably tied to his false testimony that he actually made an investment decision to exercise options) should be repudiated.

3. The Division's Continued Reliance On ALC's Purchase Of The Ventas Facilities Is Unsupported By The Facts.

The Division also asserts that a finding of materiality is supported by ALC's purchase of the Ventas properties in June 2012. (Div.Br. 45-47, 55.) The Division's argument is founded upon multiple layers of false logic and disingenuous citation to the record. (Br. 14-17.)

Because the Ventas lawsuit did not pertain to any alleged default under the financial covenants, the purported losses tied to the lawsuit are irrelevant. Thus, the Division claims Ventas' motion to take expedited discovery in the case was related to alleged financial covenant violations even though the motion states otherwise:

> Because of the increasing reports of ALC's mismanagement of the facilities, *Ventas fears that the "irregularities" are related to deficiencies in Defendants' operation of the assisted living and/or independent care facilities and the care for the residents therein.*

(Ex. 357 at 3 (emphasis added).)

The Division contends that Doman's vague testimony that the motion "may" have related to "occupancy calculations" is more probative than the motion itself. This is flawed. The Division's position is that Bebo must be lying about the Solari Call because the Solari Email does not contain additional detail or specific reference to covenant calculations. The Division argues strenuously that Bebo and GT must be lying about Board knowledge because the board minutes do not specifically confirm their discussions with the Board. But here, Doman's testimony is not only unsupported by Ventas' motion but *is flatly contradicted by it.* Yet the Division relies solely on this testimony for what it believes to be a key fact (based on it being italicized in two separate locations in its brief, at 45 and 55).

In a similar way, the Division relies upon the testimony of two ALC directors, Bell and Buntain, about their belief that, at the time, ALC was paying $20-$24 million over market value for the properties because of Ventas' May 9th letter about employee occupancy. (Div.Br. 46.) As with Doman's testimony, the directors' testimony is contradicted by the minutes of the board meeting where the purchase of the properties was approved. Those Board minutes *specifically reflect the Board's conclusion that ALC was paying market value.* (Ex. 123.) And four days before the May 15th board meeting, Bell told ALC's auditors that the financial covenant allegations related to employee-leasing were "posturing" and that Ventas' "[s]tatements are false and misleading." (Tr. 3459-60; Ex. 1880 at 4.)

Finally, investors' reaction to the announcement that ALC was purchasing the properties for $100 million precludes any finding that this was negative in a material way. In response to the disclosures of the acquisition of the facilities and anticipated one-time losses, the value of ALC to shareholders *increased* by about $28 million, exceeding the amount Bell and Buntain contend was overpaid.[7]

D. The Mere Fact That ALC Included Boilerplate Language About The Lease Does Not Make It Material.

Given the inherent weaknesses in its evidence, the Division desperately asserts that materiality is demonstrated by the mere fact that ALC filed the Lease as a material contract in early 2008 and included the challenged disclosure in its reports at all. Bebo established this type of reasoning is circular and has been rejected by courts (Br. 15), and the Division has no response. Moreover, the Division's continued reliance on the fact ALC filed an 8-K with a copy of the Lease in January 2008 (Div.Br. 6) demonstrates the ALJ's prejudicial error excluding Martin's report and testimony.[8] As noted, by failing to address any of the cases cited in Bebo's opening brief and the argument set forth therein with respect to the ALJ's error in precluding Martin's opinion and testimony in its entirety, the Division has effectively conceded the error.

In the end, the basic facts presented demonstrate that the Division's case is premised upon immaterial, insignificant boilerplate language that never changed during the time period alleged

[7] In total, ALC's stock increased from $12.80 just prior to the announcement of the transaction to the $14.00 per share close on June 22. (Ex. 2186 at 24, 37-38.) $1.20 per share multiplied by approximately 23 million shares outstanding as of March 31, 2012. (*See* Ex. 16 at 9.)

[8] In addition, the Division asserts that "ALC and its securities counsel" engaged in some deliberative process in deciding to file the lease and concluding it was material. (Div.Br. 6.) However, the Division elicited no testimony about this despite calling Buono and the head securities counsel at Quarles & Brady in its case. Since the Division did not ask securities counsel about this issue, the Commission should presume the testimony would have been adverse to the Division's position.

in the OIP except for the mathematical reduction to the calculation of the present value of future rental payments under the lease (Div.Br. 7).

II. The ALJ's Finding That ALC's Disclosures Contained A Misstatement Of Fact Was Erroneous As A Matter Of Law.

A. The *Omnicare* Standard Applies To All Of The Challenged Statements.

In Bebo's opening brief, she cited three cases where courts have applied *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318 (2015), to statements involving matters of judgment that *were not* prefaced by this kind of signaling language. (Br. 19; *see also In re Lehman Bros. Sec. & ERISA Litig.*, 2015 WL 5514692, *5 n.44 (S.D.N.Y. Sept. 18, 2015).) The Division continues to assert that not all of the statements fall within *Omnicare*, but cites no cases and sets forth no reasoning to oppose Bebo's arguments.

B. *Omnicare's* Omission Test Does Not Apply, But If It Did, There Was No Omission.

The Division also attempts to invoke the *Omnicare* omissions test with respect to establishing the falsity of ALC's opinion, even though the ALJ expressly concluded this case did not involve omissions. (Div.Br. 51.) This fails for two reasons. First, the *Omnicare* "omissions" holding does not apply to fraud claims. Indeed, the Supreme Court reasoned that the strict liability statute in Section 11 of the Securities Act of 1933 at issue in that case results in a different analysis than cases where the plaintiff must prove *scienter*. *Omnicare*, 135 S. Ct. at 1331 n.11 (citation omitted). The omissions test only applied because the claim at issue, unlike Section 10(b), was not dependent on proof of intent to defraud. *Id.* at 1330 n.9, 1337. This is confirmed by the Tenth Circuit's decision applying *Omnicare* in the 10(b) context which applied the pre-existing subjective belief and objective reasonableness standard. *Nakkhumpun v. Taylor*, 782 F.3d 1142, 1159 (10th Cir. 2015); *but see Tongue v. Sanofi*, 2016 WL 851797 (2d Cir. March 4, 2016) (applying omissions test).

Second, invoking the omission test fails on the merits even if it did apply. As set forth in Bebo's opening brief, cases like *Zaluski v. United American Healthcare Corp.*, 527 F.3d 564 (6th Cir. 2008), where a company has a reasonable defense to an asserted breach of a contract or to assertions of non-compliance with laws or regulations, there is no actionable claim under the securities laws where the issuer asserts it is in compliance.

The Division's attempt to distinguish *Zaluski* constitutes an improper bait-and-switch. *Zaluski*, which is on point, applies to the Division's claimed omission theory, but the Division attempts to distinguish it by claiming this is a misrepresentation, not omission, case: "unlike Bebo's case, the analysis was not whether there had been a false statement, but whether the company had a duty to disclose certain information." (Div.Br. 51.) This, of course, is exactly Bebo's point—just as in *Zaluski*, there was no duty for ALC to disclose the manner in which it was meeting the Lease's financial covenants here.[9] Moreover, Martin's opinion and the fact that no one ever suggested ALC disclose how it was meeting the covenants also demonstrate there was no omission.

C. The Weakness Of The Division's Position Is Established By Its Failure To Cite Any Precedent Finding Liability Under Similar Circumstances.

In its opposition brief, the Division did not cite a single case where liability was imposed for a statement affirming compliance with lease covenants. Of the several private securities cases involving motions to dismiss that were cited by the Division (Div.Br. 50 n.28), none of them were premised upon the sole allegation that a single statement affirming compliance with

[9] Similarly, the Division's effort to distinguish *Zaluski* on the basis of the court's discussion of prior caselaw that held there was a duty to disclose known information that undermined a company's discussion of "objective data" misses the point. There, as in this case, a representation of compliance with a contract or with regulations did not involve a representation about "objective data," which is why there was no duty to disclose the allegedly omitted information in the first place. The *Zaluski* court was contrasting its case with the prior precedent that did involve representations about objective data. *See also Tongue,* 2016 WL 851797, *9 (no duty to disclose facts undermining opinion).

lease or debt covenants was false or misleading. They all involved allegations regarding debt covenant compliance secondary to the primary allegations of major accounting misstatements and GAAP violations.

The weakness of the Division's position is further highlighted by its principle reliance on a decision denying a motion to dismiss in the private securities litigation against ALC and Bebo. (Div.Br. 49 (citing *Pension Tr. Fund for Operating Eng'rs v. Assisted Living Concepts, Inc.*, 2013 WL 3154116 (E.D. Wis. June 21, 2013)).)

The Division incorrectly states that the court there "reject[ed] the same arguments Bebo raises here." (Div.Br. 49.) The *Pension Trust Fund* case did not address the appropriate standard for pleading and proving a Section 10(b) claim premised upon an opinion, perhaps because that issue was not raised, given the host of other allegations unrelated to assertions of lease compliance and the unrelated resident care-related regulatory violations. The case was decided prior to *Omnicare* and there is no discussion of any other precedent involving the standard for pleading and proving claims based on opinions or judgment.

Moreover, the court's decision in *Pension Trust Fund* did not even address the issue of ALC meeting the Lease covenants through the use of the employee-leasing practice. The only reference to occupancy reporting to Ventas is the allegation that "ALC allegedly would temporarily house residents for whom it lacked the capacity to treat and rent rooms to third parties in order to temporarily inflate their occupancy rate." *Pension Tr. Fund*, 2013 WL 3154116, *3.

III. The Division Has Failed To Prove Subjective Falsity.

Under *Omnicare*, if a company asserts a legal compliance opinion, "however irrationally," no securities fraud liability will result as long as it is based on "some meaningful inquiry" rather than "mere intuition." *Tongue*, 2016 WL 851797, *7. Specific statements to others recognizing the falsity of the stated opinion or conduct—such as the sale of stock—that would be inconsistent with the stated opinion may establish subjective falsity, but general assertions of wrongdoing, of "an overarching fraudulent scheme or corrupt environment," or "sharp [business] practices" will not suffice. *See Podany v. Robertson Stephens, Inc.*, 318 F. Supp. 2d 146, 154-55 (S.D.N.Y. 2004); *In re Credit Suisse First Bos. Corp.*, 431 F.3d 36, 46–47 (1st Cir. 2005), *overruled on other grounds by Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007).

In this case, Bebo consistently expressed to others that ALC had an agreement with Ventas for ALC to pay for apartments for people with a reason to go there, and include those rentals in the covenant calculations. She consistently, repeatedly explained to internal accounting staff, to the Board members, to GT, and others that the basis by which ALC was meeting the covenants was based on the Solari Call and Email. When Buono supposedly raised concerns about the practice (testimony which is of questionable veracity), he testified that Bebo never expressed concern about the validity of the agreement and whether ALC's actions were consistent with it.[10] (Tr. 2366.) When Grochowski directly questioned the nature of the agreement in November 2011, Bebo again explained her sincere belief that ALC was in compliance with the Lease covenants. (Tr. 1155-57, 1161-62.)

At most, the Division has established that ALC and Bebo, in their interactions with Ventas, acted with ordinary advocacy in business practices between two sophisticated companies and competitors. ALC obtained a very favorable and flexible agreement in meeting the Lease covenants. ALC had no obligation to revisit the agreement with its competitor and contractual

[10] The Division's brief falsely states "Bebo admits Buono told her 'I don't look good in stripes.'" (Div.Br. 35) Bebo made no such admission, instead stating in the testimony cited by the Division that "I can't tell you a time that I can specifically remember that comment" but she did recall him making typical Buono colorful statements to prod her into getting him names on a timely basis so he could provide his reporting to GT.

counter-party. Quarles & Brady and Milbank essentially concluded ALC could defend against a default assertion when they reviewed the matter in 2012. As in the *Credit Suisse* decision, establishing sharp business practice is insufficient to demonstrate subjective falsity.

Other reasons ALC's compliance opinion was reasonable and subjectively believed are:

<u>The evidence shows there was an agreement.</u>

In her opening brief, Bebo posed a number of unanswered questions (Br. 26-27) regarding the ALJ's and Division's theory that, on the Solari Call, Bebo only discussed "whether ALC corporate employees travelling to the facilities could overnight there instead of at hotels" (Div.Br. 14). Those unanswered questions render this theory implausible. In opposition, the Division has no answer to any of these questions, because its theory cannot be squared with the truth of what happened.

The Division also focuses upon the Solari Email omitting specific reference to the covenant calculations. As Buono testified, however, he thought in 2009 there was an agreement with Ventas to include rooms for employees in the covenant calculations, because "why else would we do it?" (Tr. 2496.) And the confirmation of "rentals" in the Solari Email is far more consistent with discussion on the Solari Call extending beyond a mere request for permission for employees to stay at the facilities (and therefore indisputably more consistent with Bebo's version of the call).

But the truth does not matter to the Division, which has resulted in it taking contradictory positions. Emblematic of this is that the Division's case is built on the flawed assertion that Ventas could not possibly discern that ALC's "room rentals related to employees" would be included in the covenant calculations (despite the Division's contrary assertion that Ventas "scrutinized" everything ALC did). Yet the Division asserts that, on the other hand, public investors read ALC's May 4th press release that makes no mention of covenant calculations or reporting and must have concluded the investigation into "irregularities" with the Lease were related to covenant calculations.

Fonstad's approval of the challenged disclosure.

Another critical fact in this case is whether Fonstad was a participant in the Solari Call. The fact that he was on the call informs the significance of Fonstad's subsequent involvement and *undisputed approval* of ALC's affirmation of compliance in its periodic filings only days after Bebo forwarded Fonstad the Solari Email and Ventas' response.

The Division repeatedly asserts that "every percipient witness" disputes some specific occurrence about which Bebo testified (even if those witnesses do not dispute Bebo but simply do not recall the occurrence). However, with respect to the key fact of whether Fonstad participated in the Solari Call, every percipient witness to testify about this fact, except Fonstad, places him as a silent participant on the call in Bebo's office.[11] This includes Bebo, Buono (in his sworn investigative testimony), Kathy Buchholtz, and Joy Zaffke.

Moreover, Fonstad's role in preparing the Solari Email with Buono in the days following the conversation and receiving, printing, and maintaining in his personal files the Solari Email and Ventas' response—*with no record memorializing that Bebo had apparently disregarded his advice in its entirety (or so the Division claims)*—is all consistent with Bebo's view of the facts.

[11] Even Fonstad was equivocal, basing his testimony solely on the fact that he had not been shown any of his notes of the call. The Division on other occasions emphasizes that Fonstad took a lot of notes to support the contention that something did not happen. (Div.Br. 18-19.) This is a specious claim. Where are his notes regarding the first internal conversation about the idea of including employees in the covenant calculations? Fonstad was ALC's corporate secretary. Where are his notes of ALC Board and Committee meetings? Or his notes of disclosure committee meetings? Or his notes regarding communications with Ventas about the negotiation of the Lease? The record reflects a remarkable absence of Fonstad note-taking.

New Mexico negotiations do not show lack of an agreement, but confirm Bebo's belief.

In opposition, the Division again stretches the truth and the record beyond the breaking point. The Division contends it was established that on February 17, 2009 Bebo and Buono proposed that Ventas would waive both the occupancy and coverage ratio covenants in connection with ALC's purchase of two other Ventas properties in New Mexico. The email cited by the Division does not say this, and is double-hearsay. (Br. 40-41.)[12] In the email, Solari states they "hinted at eliminating the covenants entirely." (Ex. 188.) Solari's testimony about the email was equivocal. When asked what he was trying to convey, he said "[m]y understanding would be occupancy and coverage." (Tr. 430.) Given Solari's inability to recall any details about any pertinent conversation, including the most important phone call in this case, and his inaccurate recollection of other matters (Tr. 413, 446-51, 456-59), his purported recollection of this call is not credible.

Moreover, in light of the fact that two days later ALC specifically excluded any proposal about modifying the occupancy covenants further disputes the notion that Bebo sought occupancy covenant relief on February 17th. Why would they first talk about modifying/eliminating all financial covenants, but then only propose modifications to the coverage ratio covenants? As noted in the introduction, the Division also continues to assert patently false arguments about the February 19 email (Ex. 190).

The Disclsosure Committee.

As noted in Bebo's opening brief, the Disclosure Committee's function was to assist ALC in its disclosure obligations to investors. (Ex. 1919 at 3; Tr. 1567-68, 2445.) This included making recommendations to senior officers, like Bebo, who were not members of the

[12] Relying on the ALJ's Decision, which cites no testimony about the ambiguous email, Bebo asserted incorrectly that there was no testimony about it. There was, although it lacks credibility for the reasons explained herein.

Committee. (*Id.*) Thus, the lack of any objection or concern about ALC's Lease disclosure would naturally lead someone in Bebo's position to conclude that the disclosure was appropriate.[13]

The Division contends that the disclosure committee meeting minutes "refer generally to 'adjustments' and 'clarifications as to census,'" implying that covenant calculations were not discussed or the inclusion of employees in the covenant calculations were not discussed. (Div.Br. 60.) This is false. The 2009 meeting minutes specifically state "correspondence between ALC and Ventas has occurred whereby the *covenant calculations* have been clarified as to census." (*See, e.g.,* Ex. 124 at 3.)

Nor does it matter that, in 2015, most of the witnesses cannot recall what was said at those meetings regarding the inclusion of employees in the covenant calculations. (Div.Br. 59-60.) Some do recall the inclusion of employees in the covenant calculations being discussed by Buono at the Disclosure Committee meetings. (Tr. 3699-3700.) In fact, Hokeness, who drafted the minutes, testified that he was referring to the inclusion of employees in the occupancy covenant calculations when he wrote "the covenant calculations have been clarified as to census." (Tr. 3089-90.)

IV. The Division's Heavy Reliance On Bebo's Purported Deception Of Ventas Is Unfounded And Of Marginal Significance To Whether She Intended To Deceive Investors.

The Division's lead-off argument with respect to scienter is the fact that Bebo did not actively revisit the agreement with Ventas after the Solari Call and Email. (Div.Br. 37-38.) Even if true, this demonstrates nothing with respect to Bebo's mental state with regard to

[13] The Division's assertion that Bebo purportedly admits not knowing whether the disclosure committee even discussed the topic is similarly bogus. In the cited testimony, Bebo simply stated she did not know what documentation was provided to the disclosure committee because she was not there. (Ex. 502 at 1139.) That statement was made within the context of further testimony about her understanding that the employee leasing issue was discussed at the committee. (*Id.*) She testified similarly at trial. (Tr. 4175.)

investors. The case upon which the Division principally relies for other issues rejected this same argument: "In essence, the Pension Trust is attempting to argue that a misrepresentation to a third party [Ventas] constitutes a misrepresentation to shareholders. That position is simply untenable." *Pension Trust Fund*, 2013 WL 3154116, *13.

Rather, Ventas was a competitor, and from early 2008 sought highly sensitive information about ALC's operations so it could use that information in highly public calls with Ventas' own investors. (Tr. 355-58; Exs. 1996, 1995, 1549.) Thus, from the beginning of the relationship, ALC wanted to generally provide Ventas as little information about ALC as possible. (*See* Exs. 1254, 1118; Tr. 2742, 4146-47.) ALC's practice was to give general, standard answers to Ventas' questions to avoid competitive harm, focusing on high-level marketing/operational developments that would not include sensitive information. (Tr. 4146-48.)

This is not to say that Bebo and ALC did not subsequently revisit the employee-leasing arrangement with Ventas because they felt it would be divulging competitive information. But it reflects the lens through which Bebo viewed the subsequent interactions with Ventas in the quarterly meetings and calls.

The Division focuses on communications between ALC and Ventas in July 2009. (Div.Br. 37.) In an email, a Ventas analyst asks Herbner for some "color" about increases in occupancy at a number of CaraVita Facilities from the fourth quarter of 2008 to the first quarter of 2009. (Ex. 212.) Although the changes in occupancy from quarter to quarter were impacted significantly by the number of rooms that ALC allocated at those facilities for use by employees, ALC responded by providing general information about sales personnel changes, performance plans and other information consistent with ALC's typical answers to such questions. (*Id.*;

Tr. 4150-52.) Consistent with Ventas requesting simply additional "color," it accepted ALC's answers without further inquiry. Herbner confirmed the information provided to Ventas in response to the inquiry was truthful, but incomplete by not mentioning units for employees. (Tr. 839-40.)

Moreover, regarding this particular communication, ALC had just months before conducted the Solari Call and sent the Solari Email which Bebo observed going to three other employees in Ventas' asset management division. (Tr. 4151-52.) Thus, ALC reasonably concluded that Ventas knew there were employees included in the counts and, *as Buono testified* (Tr. 4656; Ex. 2117 at 2), Solari indicated he did not want them separately reported. (*Id.*)

The Division also asserts Bebo tried to prevent Ventas from inspecting ALC facilities. (Div.Br. 37-38.) The fact ALC required Bebo or Buono to accompany Ventas on site visits is irrelevant because it was undisputed this was a requirement for Ventas visits from the beginning of the relationship in 2008. It had nothing to do with preventing Ventas from "ascertaining occupancy," as suggested by the Division. (*See* Tr. 832-33, 4147-48, Ex. 1389.) Moreover, Bebo imposed the same requirement for other outsiders visiting other ALC facilities. (Tr. 4142-43.)

The notion Bebo tried to prevent Ventas from visiting facilities during meal times, which is based solely on testimony from Buono, is contradicted by contemporaneous documentary evidence. (*See* Ex. 1389, 1505, Tr. 200.) Moreover, this argument is irrelevant since Ventas acknowledged it never attempted even ascertain occupancy during any of its site visits. (Tr. 946-47.)

Finally, the Division relies on another false assertion that Bebo instructed Houck to remove name placards outside rooms so that Ventas could not count the number of occupied rooms. (Div.Br. 37-38.) Houck explicitly testified that he could not recall whether removing name placards at one of the facilities on the one occasion coincided with a site visit by Ventas or even whether it occurred prior to or after ALC began utilizing rooms for employees in the covenant calculations. (Tr. 1476.) The Division's constant stretching of the truth indicates a fundaments unreliability of its case and evidence.[14]

V. "Scheme" Liability Does Not Apply.

The Division continues to promote the notion that "scheme" liability applies in this case, but stunningly fails to even address *Flannery v. SEC*, 2015 WL 8121647, *9 (1st Cir. Dec. 8, 2015) which, as demonstrated in Bebo's opening brief, renders scheme liability inapposite.

VI. The Sanctions Imposed By The ALJ Were Excessive, Contrary To the Law, And Unsupported By The Evidence.

With respect to sanctions, the Division largely repeats the erroneous reasoning of the ALJ. Thus, Bebo largely relies on her opening brief in this regard. The Division's only "new" arguments are wrong as well.

The Division tries to justify the draconian $4.2 million penalty imposed by the ALJ by claiming that "a multi-million dollar penalty is well-justified and consistent with other litigated financial fraud cases against CEOs." (Div.Br. 66.) In other words, according to the Division, all "financial fraud" cases against CEOs can be treated the same. This argument is absurd.

[14] The Division's reliance upon Bebo's purported attempt to hide employee-leasing from potential buyers of ALC is similarly divorced from the facts. Far from precluding Ventas from gaining access to company-wide occupancy data (including for the Ventas facilities), Bebo deferred to ALC's Vice Chairman, Rhinelander, to decide whether to give that information to Ventas. The emails cited by the Division both specifically state Rhinelander had the final decision about whether to disclose the occupancy data being provided to the bidders generally, and specifically with respect to Ventas. (Exs. 284, 292.) Further, Rhinelander agreed he was the ultimate decision-maker about whether to disclose the information, and he made the decision to withhold it. (Tr. 2905, 2911, 2914.) At the time, Ventas was also the only potential bidder that was a direct competitor with ALC. (Tr. 2116-17.) The Division also misrepresents "Bebo admittedly believed neither ALC's buyer nor Ventas would credit her purported agreement with Solari." (Div.Br. 38.) The actual testimony cited states Bebo believed that buyers of ALC would have to "be comfortable" with the employee-leasing arrangement with Ventas, and they may perceive some risk in relying on the oral agreement and Solari Email if all of the participants to the agreement were no longer with ALC. (Tr. 2128-29.)

The Commission cannot lump together all "financial fraud" cases (whatever that term may mean) or all cases involving CEOs. Every case is different, regardless of the nature of the Division's allegations or the position the respondent occupied within his or her company; that is precisely why the law requires a case-by-case analysis of whether sanctions are appropriate, based on established criteria. And the cases cited by the Division factually different from the facts of this case. None of the penalties ordered in those cases were based on the fact that the Defendant was a CEO, or that they involved "financial fraud." Rather, unlike the present case, the penalties ordered in those cases were based primarily on the fact that the Defendants realized sizeable financial gains as a result of their misconduct. *See SEC v. Razmilovic*, 738 F.3d 14 (2d Cir. 2013) (penalty based on half the maximum digorgeable gain *of over $41 million*); *SEC v. Life Partners Holdings, Inc.*, 71 F.Supp.3d 615 (W.D. Tex. 2014) (SEC requested disgorgement of $500 million and third-tier penalties between $67.9 million and $1.5 billion); *SEC v. E-Smart Techs., Inc.*, 2016 WL 183503 (Jan. 14, 2016) ($2 million penalty based on half the amount of disgorgable gains to the Defendant).

Here, as the ALJ acknowledges, ***Bebo did not gain any financial benefit from the alleged misconduct.***[15] The mere fact that multi-million dollar penalties were deemed appropriate in other cases involving CEOs does not justify the drastic sanctions ordered in this case.

Nonetheless, the Division also claims the ALJ's calculation of penalties based on the "number of distinct violations" is well-established. The Division is wrong. None of the cases it cites supports the proposition that identical representations resulting from a single course of conduct should be punished multiple times over. In *SEC v. Huff*, 758 F.Supp.2d 1288 (S.D. Fla.

[15] The ALJ rejected the Division's claim for disgorgement in its entirety, because, as Bebo established in post-hearing briefing, there was no basis in law or fact to support the Division's theory. (Dec. 77-78.) Yet the Division, in a footnote, makes a half-hearted request for disgorgement despite failing to file a cross-petition for review. (Div.Br. 67 n.39.) This challenge to the Decision has been waived pursuant to Rule 410(b) and well-established appellate practice. *Am. Bottom Conservancy v. U.S. Army Corps of Eng'rs*, 650 F.3d 652, 660 (7th Cir. 2011).

2010), for instance, the court calculated its $600,000 penalty (a small percentage of the over $10 million disgorgement ordered) based on the number of public filings containing misrepresentations. But there each filing contained multiple different misrepresentations. Thus the court penalized the multiple distinct representations, not multiple penalties for the repetition of a single misrepresentation. The court dedicated a significant portion of its 75-page opinion to analyzing the multiple, different misrepresentations in the various public filings at issue in the case. *See id.* at 1326-1336.

The other cases cited by the Division are equally unavailing. *See SEC v. Colonial Inv. Mgmt. LLC*, 381 Fed. Appx. 27 (2d Cir. 2010) (penalties calculated based on 18 distinct trades facilitated by defendant); *In the Matter of Francis V. Lorenzo*, Release No. 74836 (April 29, 2015) (ordering respondent to pay $15,000 penalty based on two separate, and different, misleading emails sent to prospective investors). And notably, in another case cited by the Division, the Commission affirmed the imposition of a single $150,000 penalty for an entire scheme to offer fictitious securities for sale via social media. (*See* Div.Br. 67 *citing In the Matter of Anthony Fields, CPA d/b/a Anthony Fields & Associates & d/b/a Platinum Sec. Brokers*, Release No. 9727 (Feb. 20, 2015).) In that case, the ALJ treated the entire course of conduct as a single violation for purposes of calculating penalties and the Commission affirmed its decision. *See In the Matter of Anthony Fields, CPA d/b/a Anthony Fields & Associates & d/b/a Platinum Sec. Brokers*, Release No. 474 (Dec. 5, 2012) ("The events at issue will be considered as one course of action, and the $150,000 penalty that the Division requests for the antifraud violations will be imposed.")

VII. The Federal Law Enabling This Proceeding Is Facially Unconstitutional

In Bebo's opening brief, she established that Dodd-Frank Section 929P(a) is facially unconstitutional because it violates both the equal protection and due process clauses of the Fifth Amendment.

A. Dodd-Frank violates equal protection.

The Division's argument that Section 929P(a) does not violate equal protection because the government's authorization and exercise of prosecutorial discretion enjoys a "presumption of regularity" is inapposite. (Div.Br. 68 citing *United States v. Batchelder*, 442 U.S. 114, 125 (1979).) Prosecutorial discretion applies to decisions regarding "whether to prosecute and what charge to file . . . ." *Batchelder*, 442 U.S. at 124. But Section 929P(a) allows much more than that; it allows SEC prosecutors to bring claims for the *same conduct* under the *same statutes* seeking the *same remedies* in either district court or home-court proceedings. The law allows the SEC to choose whether two individuals in identical positions will be entitled to a jury trial. The Division does not, and cannot, cite authority to support its proposition that this type of discretion falls within the ambit of permissible prosecutorial discretion.

Indeed, the Supreme Court said exactly the opposite in *Baxtrom* and *Humphry*. (*See* Bebo Br. 56-58.) In *Humphrey v. Cady,* the Court found a constitutional problem with a prosecutor's discretion to prosecute the same conduct seeking the same remedy under either of two laws, only one of which provided a jury right. 405 U.S. 504, 512 (1972). The constitutional infirmity stemmed not from the prosecutor's discretion to charge one crime as opposed to another, but from the discretion to arbitrarily withhold a jury trial from some defendants but not others. Section 929P(a) suffers from the same infirmity.

The Division concludes, without any reasoning, that "the Commission may rationally determine that some cases are better resolved through administrative proceedings than in district court." (Div.Br. 68.) Far from being guided by a rational basis, the SEC's unequal treatment of respondents is actually a litigation tactic used to give the SEC its best opportunity to win. (Ex. 2063.)

B. Dodd-Frank violates substantive due process.

In response to Bebo's substantive due process argument, the Division makes the correct but irrelevant assertion that the Seventh Amendment right to a jury is not available in administrative proceedings. (Div.Br. 69 citing *Atlas Roofing v. OSHA*, 430 U.S. 442, 455 (1977).) The Division implies that because it is permitted to bring its action administratively, where there is no jury right, there is necessarily no constitutional problem with its authority to choose between that forum and district court, where a defendant does have the right to a jury.

But the Supreme Court already considered and rejected this line of reasoning in *Blackledge v. Perry*, 417 U.S. 21 (1974). There, the Court found North Carolina's law violated due process *despite* the fact that the state was not constitutionally required to provide a jury at all in the circumstances presented. *Id.* at 26 n.4. The Court explained that even though states are not "constitutionally required to establish avenues of appellate review of criminal convictions . . . it is now fundamental that, once established, these avenues must be kept free of unreasoned distinctions that can only impede open and equal access to the courts." *Id.* (internal quotation omitted).

VIII. This Administrative Proceeding Deprived Bebo Of Procedural Due Process.

As set forth in Bebo's opening brief, the procedures of the administrative process, as applied to her in this case, coupled with the ALJ's overt bias in favor of the Division, created an impermissibly high risk that her property interest would be erroneously deprived.[16] (Bebo Br.

[16] The Division does not contest that this case satisfies the other two *Mathews v. Eldridge* factors. 424 U.S. 319, 334-35 (1976) (describing three-factor test).

61-64.) Instead of engaging with Bebo's argument that it was not proper for the SEC to choose to bring its claims against her administratively because of circumstances unique to *this case*, the Division simply cites precedent finding that the SEC's various Rules of Practice have generally been found constitutionally permissible in other cases. (Div.Br. 69-71.) The fact is that the process afforded in *this case* was inadequate. Among other things, Bebo was precluded from obtaining evidence, presenting evidence, calling witnesses, and cross-examining adverse witnesses. *Jenkins v. McKeithen*, 395 U.S. 411, 429 (1969) (even in administrative context, due process requires respondents be afforded right to confront and cross-examine witnesses).

A. Testimony From Foreign Witnesses.

The most glaring example of the lack of process in this case is the SEC's choice to bring its claims in this forum as a litigation tactic designed to deprive Bebo of the ability to compel testimony from (or cross-examine) key foreign witnesses who reside outside the subpoena power afforded these proceedings—access she would have been afforded in federal court.

The Division took testimony from several foreign witnesses, without Bebo or her counsel present, at the end of its two-year long investigation, a month-and-a-half *after* it provided Bebo a Wells notice, when it clearly anticipated bringing its claims administratively.[17] That testimony was taken not for investigative purposes, but as a direct examination for use in these proceedings. (*See* Tr. 9-11.) Indeed, Canadian witnesses who did testify at the hearing (voluntarily, as they were not subject to subpoenas) indicated that they met with enforcement staff the morning of their investigative testimony or the day before (Tr. 661-62; Tr. 2926-27), presumably to rehearse the direct examination that would follow. Although the Division ultimately withdrew its request to admit the transcripts of ALC's Canadian chairman, Hennigar,

[17] The Division issued its Wells notice on June 12, 2014. It took compelled testimony from foreign witnesses between July 24 and August 1, 2014. (*See* Exs. 3691, 3698-99, 3707-08, 3711.) It obtained proffer agreements from Ng and Hennigar on July 18, 2014. (Exs. 1982,1984.)

and Audit Committee chair, Ng (Tr. 4541), the ALJ stated he had read the transcripts *before trial.* (Tr. 106-07.)

And the ALJ did admit, over Bebo's objection, prior deposition testimony of one of the foreign witnesses, Hennigar, from unrelated litigation that preceded the Division's enforcement action. (Ex. 492A; *see also* Div.Br. 21.) The ALJ said admission of the testimony was not prejudicial, despite the fact that Bebo could not cross-examine Hennigar at the hearing, because Bebo had an opportunity to question Hennigar during the 2013 deposition. (Tr. 4541-42.) But the employment litigation in which Hennigar sat for a deposition took place long before the Wells notice and involved issues completely separate from the issues here; Bebo did not have an opportunity then to question him about the issues specific to *this* proceeding. The only party who knew, before December 2014, of the Division's plans to pursue Bebo in an administrative proceeding was the Division.

It appears that Ng, in particular, could have provided materially favorable testimony had Bebo been able to ask her any questions. Other witnesses and documents indicate she was aware of employee-leasing, although the ALJ found the record ambiguous and therefore concluded the opposite. (*See, e.g,* Ex. 1115; Tr. 2523-24, 3435-36.)

The Division's sole response defending the general constitutionality of the Rules of Practice is illogical, and the failure to address the specific constitutional deprivation amounts to a concession that its forum choice was a deliberate, strategic decision to deprive Bebo of the right to present and cross-examine witnesses.

B. Speculative Testimony Bebo Was Not Permitted To Rebut.

The Division attempts to support its reliance on speculative testimony about what Ventas "would have done" based on its typical practices by saying that witnesses have been permitted to speculate in other cases about what they might have done in a given situation. (Div.Br. 14 n.8).

This misses the point. The procedural due process violation stems not from the ALJ allowing testimony at the hearing (though it was improper from an evidentiary standpoint), but precluding Bebo from taking any discovery (having quashed her subpoena to Ventas) to respond to or challenge that hearing testimony. This was also driven by forum selection; the ALJ recognized the ability to procure documents, such as those sought here, is broader in federal court. (Tr. 779-80.)

Dated this 14th day of March, 2016.

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CERTIFICATE OF COMPLIANCE

Pursuant to Commission Rule of Practice Rule 450(d), I hereby certify that the Respondent's Reply Brief In Support Of Her Appeal To The Commission complies with the length limitation set forth in Commission Rule of Practice 450(c) and the Commission's December 8, 2015 Order. According to the Word Count function of Microsoft Word, this brief plus the text (125 words) of Respondent Laurie Bebo's Sealed Supplemental Reply Brief Regarding Her Ability To Pay Penalties Ordered By The ALJ contains 10,454 words, exclusive of the table of contents, table of authorities, cover page/caption, and this certification.

Dated: March 14, 2016

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