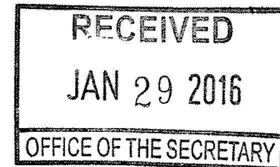
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16293

In the Matter of

LAURIE BEBO, and
JOHN BUONO, CPA

Respondents.



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

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VIOLATIONS FOUND AND SANCTIONS IMPOSED WERE IMPROPER

I. The Disclosure Claims Are Improperly Premised Upon Immaterial "Boilerplate" Language Discussing Compliance With A Non-Material Lease.

A. Factual Background To ALC And Ventas.

From November 2006 to July 2013, Assisted Living Concepts, Inc. ("ALC") was a publicly-traded company, with shares traded on the New York Stock Exchange. ALC's business was owning and operating senior living facilities in various regions throughout the United States. At the end of 2009, ALC owned and/or operated 215 assisted and independent living residences in 20 states totaling 9,398 units. (Ex. 5 at 3.)[1] ALC operated about the same number of facilities and units throughout the relevant time period, with 211 facilities as of the end of 2011. (Ex. 13 at 3.)

ALC preferred to own most of its facilities—161 of the 211 it operated as of the end of 2011. It leased the other 50 facilities. (Ex. 13 at 4-5; Tr. 2856, 3876-77, 3879-87, 4600-01.) From 2009 to 2011, ALC generated revenues of approximately $230 million and net income of $16-$24 million, and cash flows from operating activities of approximately $44-$55 million. (Ex. 377 at 6-7, n.6.)

ALC's financial performance was largely driven by company-wide private pay occupancy. (*See* Tr. 2570-71, 3834; Ex. 13 at 20-21, 24.) ALC tracked occupancy in its facilities based on the number of units occupied, even if more than one person occupied the unit. (Tr. 4105-06.) ALC never tracked whether a resident was actually living in or staying at its facilities for occupancy purposes, but counted it as "occupied" as long as there was a commitment to pay for the unit. (*See* Tr. 512-13, 1482-83, 2414, 4105-06.)

[1] Citations to pages of the record exhibits are to the page of the pdf unless otherwise indicated.

Every night, senior management, divisional personnel, regional personnel, and others would receive a nightly occupancy snapshot, broken out by region and facility, for the entire Company. (Tr. 2959-61; Ex. 2133.) They were passed out at Board meetings. (Tr. 2868-70, 2959-61.) None of the data included units related to employee-leasing.[2] (*Id.*; Tr. 1484.)

At all times relevant, Ventas, Inc. was a large, publicly-traded healthcare real estate investment trust based in Chicago, Illinois. In 2008, at the time the Lease with ALC was executed, Ventas owned a portfolio of 513 senior housing and healthcare-related properties. (Ex. 2106 at 83.) These included 440 "senior housing communities" and skilled nursing facilities. (*Id.*) A number of these properties were in the same markets as ALC facilities, so that Ventas was a direct competitor to ALC (particularly with respect to its operating portfolio). (*See*, *e.g.*, Tr. 299-300.) As Ventas grew between 2008 and 2012, the number of markets where it competed with ALC also grew. (*See* Tr. 261-62, 2831, 4138-39.)

Ventas has an acquisitions group that works hand-in-hand with its asset management group. Joe Solari was the Managing Director-Acquisitions at Ventas, and he negotiated the terms of the Lease (defined below) with ALC. As Solari acknowledged, he later became ALC's principal contact and relationship manager for all things related to the Lease. (Tr. 399-400, 444-45.) Solari was a senior executive of Ventas who reported directly to Ray Lewis, Ventas' Chief Investment Officer. Lewis reported directly to Ventas' CEO Debbie Cafaro. (Tr. 442-43.) In a December 2008 meeting, Cafaro told Bebo and Buono that Solari should be their point of contact

[2] As used herein, reference to "employee-leasing," "employee-leasing program" or similar language refers to the practice whereby ALC paid for units at the CaraVita Facilities for employees with a reason to go to those Facilities. It also includes the circumstance of ALC paying for rooms in those few situations where units were used or available to family members of employees or other contractors who were performing services in furtherance of the operations of the Facilities.

for "everything" important regarding the relationship between the two companies, including issues pertaining to the Lease.[3] (Tr. 2741-42; *see also* Tr. 3992.)

B. The "Boilerplate" Language Was Deemed Unimportant By Analysts, Investors, And Others At ALC.

There is no dispute in this case that ALC's periodic filings with the Commission accurately stated the Company's overall occupancy, or that ALC accurately stated the Company's revenue, expenses, profits, EBITDA, and other financial metrics in all of its filings with the Commission. Rather the Decision concluded that ALC misrepresented that it was in compliance with an operating lease governing eight of the over 200 facilities that ALC owned or operated.

Effective January 1, 2008, various subsidiaries of ALC entered into an Amended and Restated Master Lease Agreement (the "Lease") with a subsidiary of Ventas whereby ALC rented eight senior living facilities located in several states in the Southeast United States (the "CaraVita Facilities"). Although ALC filed an 8-K and a copy of the Lease with the Commission when it entered into the Lease, it was not required to do so. Rather, the unopposed testimony of Bebo's expert, David B.H. Martin, established it would have been reasonable and consistent with public company disclosure practices for ALC to conclude that the Lease was not material under SEC regulations governing material contracts, but file it anyhow. (Ex. 2187 at 3-9.) Martin is the former Director of the SEC's Division of Corporate Finance (and held other positions with the Commission). For the past 32 years he has been advising public companies on their disclosure obligations under the federal securities laws. (*Id.* at 1-2.) As set forth in more detail below, the ALJ improperly excluded Martin's entire report and precluded him from testifying, *sua sponte*.

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[3] Consequently, the ALJ's conclusion that Solari somehow lacked both apparent and actual authority to reach agreement with respect to the covenants (Dec. 5, 24-25, 29-30) is simply contrary to the facts and black-letter law. *See* 12 Williston on Contracts §35.11 (4th Ed.).

Beginning with the third quarter of 2008, ALC started including a disclosure in its periodic filings with the Commission about the possible unfavorable impact of a provision of the Lease. (*Id.* at 10.) A substantially similar disclosure was repeated in every subsequent filing related to each quarter during 2009, 2010, and 2011. (Dec. 50-51.)[4] This disclosure appeared under the caption "**Future Liquidity and Capital Resources**," and imbedded within a full-page, 332-word disclosure about ALC's revolving credit facility was the following challenged statement about the Lease:

> In addition, the failure to meet certain operating and occupancy covenants in the CaraVita 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. We were in compliance with all such covenants as of September 30, 2008, but declining economic conditions could constrain our ability to remain in compliance in the future.

(Ex. 2123 at 42-44.)[5]

Beginning with its 10-Q for the second quarter of 2011, ALC added the following sentence to the end of the disclosure: "Based upon current and reasonably foreseeable events and conditions, ALC does not believe that there is a reasonably likely degree of risk of breach of the CaraVita covenants." (Dec. 51.) Otherwise, ALC's disclosure remained unchanged throughout the entire time period.

Bebo's second expert, Professor David Smith, testified at trial that in his vast experience analyzing public company filings related to covenant violations, the disclosure at issue here was "boilerplate language that's in a lot of 10-Ks of firms that have financial covenants." (Tr. 3631.) Other hearing evidence demonstrated this statement was universally overlooked for the insignificant boilerplate language that it is.

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[4] The ALJ's Initial Decision (the "Decision") is cited in this brief as "Dec. __."

[5] "Occupancy" and "occupancy rate" were ambiguous, undefined terms in the Lease.

It was so inconsequential that ALC's general counsel at the time, Eric Fonstad, could not recall any discussion about it at the Disclosure Committee meetings he chaired and could not recall any legal advice that he provided with respect to the disclosure (though it was indisputable that he did approve the affirmation of compliance in February 2009). (Tr. 1569-71, 1593, 1597, 1603.) Similarly, ALC's general counsel who succeeded Fonstad has no recollection of the discussions at the Disclosure Committee about it and the additional sentence added to the second quarter 2011 filing. (Tr. 4379-81.) Nor could she recall a single detail about discussions of this disclosure at a Board meeting in July 2011. (Tr. 4378-79.)

ALC's director of financial reporting, John Lucey, and ALC's director of Internal Audit, David Hokeness, could not recall any specifics with respect to discussions of the disclosure at ALC's Disclosure Committee meetings other than what was contained in the minutes. (Tr. 3708, 3712-13, 3082-87.) Even a Ventas witness testified that she never noticed whether ALC's filings mentioned the Lease or covenant compliance in her review of them. (Tr. 951.)

Moreover, ALC's stock was covered by several stock market analysts who prepared periodic reports about the Company (*see* Ex. 2186 at 18-23; Tr. 3645-47), and the Division did not present any evidence that analysts believed the Lease or compliance with the financial covenants (or the unspecified covenants contained in the challenged disclosure) was material or important. Therefore, it can be inferred that no questions were asked about the Lease covenants on any ALC earnings calls with investors and analysts. This lack of evidence demonstrates the challenged disclosure was immaterial. *See Flannery v. SEC*, 2015 WL 8121647, **7-8, 10 (1st Cir. Dec. 8, 2015).

II. The Disclosure Claims Must Be Dismissed Because The ALJ Erred As A Matter Of Law And Fact In Finding Material Misstatements.

The Supreme Court explained "to fulfill the materiality requirement 'there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.'" *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 448 (1976)).

A. The ALJ Improperly Rejected Professor Smith's Event Study That Confirmed Investors Viewed The Alleged Misstatements As Immaterial.

The best way to determine whether undisclosed information is material is to assess the effect disclosure of the information has on the company's share price. *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 when the market is efficient); *SEC v. Mangan*, 598 F.Supp.2d 731, 735 (W.D.N.C. 2008) (same). That is because the market "is the most accurate and unbiased measure of whether reasonable investors found the information to be material." *Mangan*, 598 F.Supp.2d at 73.

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 also Greenhouse v. MCG Capital Corp.*, 392 F.3d 650, 660-61 (4th Cir. 2004); *Oran v. Stafford*, 226 F.3d 275, 282-83 (3d Cir. 2000); *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997); *Grimes v. Navigant Consulting, Inc.*, 185 F.Supp.2d 906, 914 (N.D. Ill. 2002). To be a "corrective disclosure," the disclosure has to reveal the falsity of prior statements. *Katyle v. Penn Nat'l Gaming, Inc.*, 637 F.3d 462, 473 (4th Cir. 2011) (to be a corrective disclosure, the new disclosure "must reveal to the market in some sense the fraudulent nature of the practices about which a plaintiff complains"); *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 175 n.4 (2d Cir. 2005).

Here, the first and only public, corrective disclosure occurred on May 14, 2012. And Smith's study demonstrated that, when investors first learned about the alleged falsity of ALC's prior statements of compliance due to alleged improper employee-leasing, there was no statistically significant price reaction in ALC's stock. (Ex. 2186.) The ALJ's decision disregarding Smith's conclusion is based merely upon his own speculation and must be rejected. The true facts leading up to the May 14 corrective disclosure are as follows.

On April 26, 2012, Ventas filed a lawsuit against ALC (Ex. 2075) alleging that regulatory notices identified numerous deficiencies with the respective CaraVita Facility's operations which were "jeopardizing the health, safety, and welfare of the residents." (Ex. 2186 at 9.) It contained no allegation related to financial covenant violations. (Dec. 61.) The next day, ALC sent a settlement proposal to Ventas that included a statement in the release that Ventas was specifically releasing claims "based upon [ALC] renting rooms on the Properties to certain of its employees and including those employees in certificates and covenant calculations..." (Exs. 1535, 1535A at 2.)

On May 4, 2012, Ventas sent another default notice to ALC alleging that it violated the reporting obligations under Section 25 of the Lease because it failed to timely provide actuarial reports, regulatory deficiency reports, regulatory notices, and cost reports. (Pet. for Review, Ex. A.) There is no allegation in the letter that any of the reporting violations related to the financial covenants.

On May 9, 2012 Ventas sent another default notice to ALC alleging additional licensing-related defaults, failure to provide notice of a fire, and stated "[a]s described in our letter dated May 4, 2012, Tenant has not complied with all of its reporting obligations pursuant to Section 25 of the Lease." (Ex. 355 at 5-6; Tr. 347-50.)

In the same notice, Ventas included a separate allegation related to "treating units leased to employees as bona fide rentals by third parties." (Ex. 355 at 5.) In connection with this financial covenant allegation, the default notice contains no reference to this constituting a violation of Section 25 reporting requirements.[6]

The next day, Ventas filed a motion to amend its complaint against ALC, with the proposed amended complaint attached. (Ex. 2186 at 10.) Ventas included all of the allegations from the May 9 letter described above, *except* for the financial covenant allegation. (Ex. 1194; Ex. 2076; Division Pre-hearing Br. at 18 n. 5 (stating "[r]ather than referencing the May 9 letter alleging fraud against ALC, paragraph 53 of the OIP incorrectly alleges that, after receiving ALC's request for the release, Ventas moved to amend its complaint against ALC to include allegations of fraud relating to ALC's inclusion of employees in the covenant calculations. The Division apologizes for this mistake.").)

Nonetheless, on May 14, ALC filed an 8-K publicly disclosing for the first time that Ventas had alleged that ALC had been fraudulently calculating the financial covenants by treating units rented to employees as bona fide rentals to third parties. (Ex. 2076.)

Investors did not view this information as material because ALC's stock price did not change in a statistically significant way. In the Decision, the ALJ acknowledged the expertise, credibility and event study methodology of Smith, but found an abnormal price decline on May 4 confirmed the materiality of the challenged disclosure and the May 14 8-K was not the appropriate corrective disclosure date. (Dec. 60-61.) The May 4 decline followed ALC's disclosure it had postponed its earnings release the day before because (a) there was bad news

[6] Notably, when this letter was received by ALC, its auditor had a discussion with two board members about the financial covenant allegations. In that conversation those board members stated that ALC's "position is that this letter is posturing. Quarles & Brady [ALC's outside counsel] has drafted a letter in response. [Ventas] Statements are false and misleading but has not been mailed yet due to ongoing negotiations." (Tr. 3459-60; Ex. 1880 at 4.)

rather than the good news investors anticipated; (b) the Ventas lawsuit, and (c) that it had hired outside counsel to "investigate irregularities in connection with the Company's lease with Ventas." (Ex. 2075.)

The ALJ first erred by conflating public disclosure of allegations of financial covenant violations with facts and circumstances occurring out of public view: "I disagree with Smith's contention that the May 4, 2012 disclosure did not relate to the financial covenant calculations at all." (Dec. 61.) Smith made no such conclusion. What he did conclude was—and the public record confirms—that there was no *public* indication that the May 4 disclosure of an investigation into "irregularities" in connection with the Lease related to financial covenant allegations. Smith testified why the May 4 disclosure was not relevant:

> There's no public disclosure that connects that statement of possible irregularities with the company's lease to the financial covenant allegations.
>
> There's no -- certainly it's not in the 8-K. If you look at the press analysis, you look at the analyst reports that follow this, everybody that's looking at that sentence is not making any connection to anything having to do with financial covenants.
>
> And if anything, they make the natural connection that the investigation into the lease irregularities have to do with the allegations and the alleged breaches under the Ventas lawsuit. There's nothing here that says, hey, financial covenant allegations. Nothing.

(Tr. 3645-47.) Smith went on to explain how, after reviewing "every press report" and "every analyst report ... nobody makes [the] connection" between the irregularities and financial covenants. (*Id.*) The ALJ's opposite conclusion must be rejected as it is contrary to the evidence presented, and entirely speculative.[7]

[7] For example, the ALJ writes, "Although ALC did not specifically mention the financial covenant allegations, investors *could have* reasonably assumed that the 'irregularities' might end up being substantiated." (Dec. 61 (emphasis added).) In reality, ALC did not specifically or generally mention the financial covenant allegations on May 4, and the evidence shows investors tied those irregularities to the allegations of patient safety and care at issue in the Ventas lawsuit. And aside from being entirely speculative, whether *those* "irregularities" were substantiated is irrelevant.

Second, the ALJ's further speculation about investors' potential interpretation of the May 4 disclosure based on his analysis of the syntax of the disclosure cannot substitute for *actual evidence to the contrary*. There is no evidence to support the ALJ's conclusion that ALC's statement that it intended to retain outside counsel for the investigation (Dec. 61-62) had any importance to investors, and it was speculative to conclude that investors tied the retention of outside counsel to potential misconduct with respect to including employees in financial covenant calculations.

Third, the ALJ erred in his divination that investors could have "with minimal effort," linked the following paragraph of the amended complaint (filed as an exhibit to a motion for leave to amend on May 10) to the disclosure of "possible irregularities" in connection with the Lease:

> 53. Additionally, the ALC Entities have failed to comply with their reporting obligations under Section 25 of the [Lease].

(Dec. 62 citing Ex. 1194.)

But even Ventas did not think that the disclosure of "irregularities" pertaining to the Lease had anything to do with the financial covenants. In the days following the disclosure of the internal investigation, Ventas filed a motion for expedited discovery about the investigation. Ventas stated it feared the "irregularities" pertained to staffing and care of the residents at the leased facilities. (Ex. 357 at 3.) The motion never mentions the financial covenants or ALC's reporting obligations more generally under the Lease. Thus, Ventas confirmed the opposite of the ALJ's conclusion and tracked Smith's testimony about investor and analyst (*i.e.* public) perception of the disclosure.

Moreover, even if the ALJ's inferential leap was warranted, it demonstrates nothing about whether the share price decline was caused by information disclosing that ALC had been

meeting the covenants through employee-leasing. Consequently, the conclusion that the "drop in stock price on May 11, 2012, was at least partially attributable to the amended complaint" (Dec. 62), which also contains no reference to allegations of financial covenant violations, is irrelevant.

Finally, the ALJ builds upon each of the illegitimate factual findings described above to reach the following penultimate erroneous conclusion: "The May 14 disclosure was much more detailed than the May 4 disclosure, but a reasonable investor could have inferred enough information from the May 4 disclosure, combined with Ventas' May 10 motion to amend, that the May 14 disclosure would have added little to the mix." (Dec. 62.) The plain, undisputed fact is that the May 14 disclosure *was the first time that ALC provided any disclosure at all about an allegation that ALC had breached the Ventas Lease through employee-leasing.* To conclude that the "May 14 disclosure is best considered as inconclusive evidence," as the ALJ does, is arbitrary, capricious, and a patent substitution of the ALJ's biased viewpoint for the actual facts and the well-reasoned, well-founded expert opinion of Smith.

In the end, however, the ALJ's analysis must be rejected for a more fundamental reason: even the facts as he found them do not constitute a corrective disclosure for purposes of assessing materiality through the use of an event study *as a matter of law*. *See Meyer v. Greene*, 710 F.3d 1189, 1201 (11th Cir. 2013); *In re Almost Family, Inc. Sec. Litig.*, 2012 WL 443461, *13 (W.D. Ky. Feb. 10, 2012) ("Numerous federal district courts have held that a disclosure of an investigation, absent an actual revelation of fraud, is not a corrective disclosure.") (collecting cases). As in these cases, the facts relied upon by the ALJ are legally insignificant because there was no revelation of the specific fraud at issue.

B. The ALJ Improperly Excluded Bebo's Other Experts.

Without any motion or request from the Division, the ALJ excluded the entire expert report of Bebo's expert in public company disclosure practices, Martin, and all but two pages of

the report of Bebo's expert in the assisted living industry, John Durso.[8] (Dec. 48-49, 58.) This was legal error as a matter of procedure and substance. *See United States v. Davis*, 471 F.3d 783, 789 (7th Cir. 2006) (experts are allowed to testify about "whether transactions comply with regulations" and how those regulations are enforced); *United States v. Owens*, 301 F.3d 521, 527 (7th Cir. 2002); *Huddleston v. Herman & MacLean,* 640 F.2d 534, 552 (5th Cir.1981), *modified on other grounds*, 459 U.S. 375 (1983) (attorney expert in securities law allowed to testify that a statement in a prospectus was standard language for the issuance of a new security because this information was relevant to scienter and materiality); *United States v. Bednar*, 728 F.2d 1043, 1048 (8th Cir. 1984) (permitting expert testimony about whether a document "is required to be kept by ... SEC rule"); *United States v. Garber,* 607 F.2d 92, 99 (5th Cir.1979).

The ALJ's total disregard of the unrebutted reports of Martin and Durso was particularly prejudicial because those reports provided relevant, persuasive evidence with respect to the reasonableness of Bebo's and ALC's compliance judgment, Bebo's state of mind, and the lack of materiality of the Lease in the first instance.

C. The Thin Evidence Presented By The Division And Relied Upon By The ALJ Cannot Support A Finding Of Materiality.

1. The fact ALC included the statements in its periodic filings cannot support a finding of materiality.

Precluding Martin's testimony was particularly prejudicial because, at the same time, the ALJ reasoned that the mere fact that ALC filed the Lease as a material contract, included the challenged statements in its Commission filings, and also disclosed the worst case scenario of a default under the Lease supports a finding of materiality. (Dec. 57-58.) This is tantamount to

[8] The ALJ's conduct supports the inference that he pre-judged matters in this case. When excluding this expert testimony, the ALJ also directed the Division to perform a "robust examination" of Smith, Bebo's one remaining expert. (Tr. 1761.) In the same discourse, the ALJ made it plain to Bebo and counsel that he disliked the fact that he was required to stay in Milwaukee for the lengthy hearing. (Tr. 1761-63.)

saying that *any* disclosure is material because it is included in a periodic filing. This should be rejected for the circular reasoning it is, as at least one other court considering a similar argument has determined. *SEC v. Reyes*, 491 F.Supp.2d 906, 912 n.6 (N.D. Cal. 2007).[9]

2. Reliance on an accounting standard and the Division's accounting expert was flawed.

Second, the ALJ relied on Staff Accounting Bulletin (SAB) 99 as a proxy for the legal standard of materiality in this case. (Dec. 56.) SAB 99 is Commission guidance for accountants in determining when financial statement errors could be material. Neither the Division's briefs nor the Decision cite any authority to support the conclusion that SAB 99 should constitute the legal standard to be applied in any case, much less a case that does not even involve allegations of accounting errors. SAB 99 sheds no light on materiality in these circumstances.

Similarly, the ALJ's reliance on the Division's audit expert, John Barron, was erroneous. It was established on cross-examination that Barron's opinions were unreliable and did not support any finding of materiality. (Tr. 1655-56, 1662, 1670, 1677-79, 1680-83.)

His opinion was based on the false assumption that every event of default would necessarily result in the imposition of the worst-case scenario of acceleration of all future rent and termination of the Lease. (*Id.*; *see also* Ex. 1231, 364; Tr. 2298-99, 3568, 3634-35, 3660-63.) The ALJ rejected the contention that Barron's opinion contained such an assumption (Dec. 58-59), but it is clearly stated in his expert report: "It is my understanding that there are requirements in the law for persons who have suffered damages to take reasonable actions to mitigate the loss suffered. It is not possible for me to take such, or other, potential outcomes into account in reaching a conclusion with respect to the materiality of potential losses in accordance

[9] The ALJ's conclusion that materiality is supported because "integrity of management is [always] important to the reasonable investor" (Dec. at 63), should be rejected for the same reason: it essentially eliminates the materiality standard entirely.

with the terms of the Ventas lease." (Ex. 377 at 21.) Moreover, the Division's own witness established the fallacy of this assumption: ALC's outside securities counsel, Quarles & Brady, testified that not all events of default are material. Rather each must be evaluated based on its own facts and circumstances. (Tr. 2297-99.)

The ALJ erred in "accord[ing] Barron's opinion considerable but not dispositive weight" (Dec. 59), instead of disregarding it and giving it no weight as urged by Bebo in post-hearing briefing. It is well-established that an expert can base his opinion on underlying facts or assumptions he did not find on his own only if competent evidence is also presented to prove the truth of those underlying assumptions. *Dura Auto. Sys. of Ind., Inc. v. CTS Corp.*, 285 F.3d 609, 615 (7th Cir. 2002); *Target Mkt. Publ'g, Inc. v. ADVO, Inc.*, 136 F.3d 1139, 1144-45 (7th Cir. 1998); *Victory Records, Inc. v. Virgin Records Am., Inc.*, 2011 WL 382743, *2 (N.D. Ill. Feb. 3, 2011). That did not occur here.

3. ALC's purchase of the Ventas properties long after Bebo left ALC cannot support a finding of materiality.

The Decision also improperly accorded "significant weight" to ALC's alleged over-payment for the CaraVita Facilities. (Dec. 59.) Indeed, this conclusion is fundamentally flawed because the undisputed facts established that this was a highly favorable transaction for ALC, that it added approximately $2.40 of value per share to the Company, and would increase the Company's cash flow (a key metric investors used to analyze ALC). (Ex. 1108; Ex. 1108A; Tr. 4605-08.) Not surprisingly, ALC's stock price went up in response to the announcement that it had purchased the CaraVita Facilities for $100 million and would be recording the one-time write-offs. (Ex. 2186 at 23-24.) Even the accounting standard Barron relied on states that an increase in stock price demonstrates lack of materiality. (RDX 2-9; Ex. 377 at 16.)

As noted earlier, ALC had a strong preference for owning its facilities instead of leasing them. Thus from 2008 to 2011, ALC made several overtures to Ventas about buying the eight CaraVita Facilities for up to $85 million. (Exs. 3248, 1486; Buono, Tr. 4594-97.) Around January 2012, ALC inquired about buying those facilities, plus four other facilities that Ventas had acquired from a company called NHP that were subject to a different lease with ALC. In January and March of 2012, ALC made proposals to buy all 12 properties for between $88 million and $99 million. (Exs. 317, 1514; Tr. 4597-99, 4601-02.)

Consequently, the facts establish that an acquisition of the 12 properties for $99 million was attractive to ALC for many reasons weeks before Ventas ever asserted an event of default with respect to the licensing issues, and two months before Ventas ever raised financial covenant allegations.

Contrary to the ALJ's finding (Dec. 59), the other evidence demonstrated that ALC did not over-pay for the twelve properties when it bought them for $100 million. *First*, the Board minutes establish the purchase was driven by factors that had nothing to do with the financial covenants. When the Board approved the transaction, the meeting minutes noted that the Ventas lawsuit regarding license revocation notices "had merit." (Ex. 1093 at 2-3.) The minutes make no reference to any financial covenant allegations driving the purchase, and reflect that the Board concluded $100 million was market value.[10] (*Id.*) In other circumstances, the ALJ made findings adverse to Bebo because information contained in or omitted from the Board minutes was the most reliable evidence of the Board's decision and knowledge. (Dec. 43.) Here he ignored the import of the Board minutes.

[10] Ventas confirmed that the properties' market value was $100 million. (Tr. 366.)

Second, other evidence demonstrates that the licensing default issues may have played a role in driving the settlement, but the financial covenant allegations did not:

- The purchase was part of a settlement of the Ventas lawsuit which never involved allegations related to the financial covenants. (Exs. 364, 2186 at 7-8.)
- ALC's outside counsel provided two separate legal opinions. In one opinion, it concluded ALC had virtually no defense to the license revocation defaults alleged in the lawsuit. (Ex. 1050.) In the other, it concluded that ALC acted reasonably in paying for units for use by employees. (Ex. 1037.)
- ALC's general counsel ignored any issues relating to the covenant calculations during this time because she had to prioritize the "major significant issues from a regulatory standpoint" which were a potential event of default under the Lease. (Tr. 4393-94.)

Third, the ALJ improperly focused on the appraisals that ALC received and the accounting for the transaction, both determined months after the transaction and months after Bebo was removed from ALC. (Dec. 59-60.) Troublingly, the ALJ again changed his view of the weight of the evidence to suit the government's case—he dismissed exculpatory evidence because it was based on events occurring after Bebo was gone from ALC.[11]

Although only two of the twelve appraisals were even admitted into evidence, the evidence demonstrated that ALC desired to have all of the appraisals as low as possible because it had already determined that any difference between the appraised value and the purchase price would be written off for tax purposes. (Tr. 4609-11.) The fact that the appraisals were artificially low was confirmed by the fact that ALC obtained other appraisals on two of the four NHP properties earlier in 2012 which appraised their value at $4 million more than the subsequent appraisals *valued all four properties combined.*[12] (Ex. 2088.)

[11] For example, the ALJ relied on GT's concurrence with ALC's accounting determinations about the purchase of the properties (Dec. 59-60), but did not credit GT's determination that ALC's internal controls and financial statements were permissible after the Milbank investigation through which they learned all of the pertinent details of ALC's internal processes (to the extent GT was not aware of them before) (Dec. 68).

[12] Moreover, Durso confirmed that the appraisals relied upon by ALC after Bebo left and by the ALJ in reaching his conclusion utilized a very low "cap rate" which drove down the value significantly. (Tr. 3150-51, 3154, 5155-57.)

The ALJ's reliance on ALC's subsequent accounting memorandum was similarly faulty because the drafter did not know the lawsuit failed to include financial covenant allegations. (Tr. 3741-42.) Because ALC's litigation counsel concluded that the regulatory defaults were virtually indefensible and entitled Ventas to the full range of remedies under the Lease, there is no basis to conclude, as the ALJ does, that ALC could have achieved a better settlement "on terms that incorporated only damages for regulatory breaches." (Dec. 64.) The ALJ made no attempt to parse out what portion of the losses could be attributable to the purported financial covenant defaults versus the licensing defaults, and there is no evidence upon which to perform such an analysis.

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

A. The ALJ Misapplied The *Omnicare* Standard For Proving The Falsity Of Opinion Statements.

Section 10(b) prohibits the making of an untrue or misleading statement of material *fact*. Statements of opinion—such as the statement that asserted ALC's compliance with the Lease covenants—are only actionable under limited circumstances. *See Omnicare, Inc. v. Laborers Dist. Council Contr. Indus. Pension Fund,* 135 S. Ct. 1318, 1327 (2015); *Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1095-96 (1991). Because a claim based on an opinion turning out to be incorrect would be impermissibly based on hindsight, the Division was required to prove both that (1) the opinion stated was unreasonable; and (2) the speaker of the opinion knew that the opinion was incorrect or did not believe it was accurate herself. *See Omnicare*, 135 S. Ct. at 1326-27.

In *Omnicare*, the Supreme Court held that under the securities laws statements of opinion can be false only if the speaker did not hold the belief she professed. *Id.*. The Court reasoned that a sincerely held statement of opinion cannot be an untrue statement of material fact, *even if*

the opinion ultimately proves to be incorrect, because the securities laws do not permit "second-guess[ing] inherently subjective and uncertain assessments." *Id.* at 1327; *see also Nakkhumpun v. Taylor*, 782 F.3d 1142, 1159 (10th Cir. 2015) (applying *Omnicare*).

The Decision, however, failed to view Bebo and ALC's compliance judgments through the lens of reasonableness, and instead evaluated, with the benefit of hindsight, whether those judgments were correct. Thus, the ALJ found liability in a way the Court in *Omnicare* held was forbidden—second-guessing ALC's and Bebo's assessment that the telephone call and subsequent email with Solari were sufficient bases to conclude they were in compliance with the financial covenants by including ALC rentals related to employees. Viewing the facts through the lens of reasonableness would necessarily change the inferences that must be drawn.

B. The ALJ Erred In Concluding That The "Compliance Statements" Were Not Statements Of Opinion Under *Omnicare* And Its Progeny.

The ALJ found ALC's statement that it "believe[d]" it would not default under the Lease in the foreseeable future, which was only included in the last three challenged filings, was a "Belief Statement" subject to *Omnicare*. However, he erroneously concluded that the statement in each filing that ALC was in compliance with covenants—so-called "Compliance Statements"—were not subject to *Omnicare*. (Dec. 50-51.)

As part of its analysis, the *Omnicare* Court first discussed the distinction between a statement of "fact" and a statement of "opinion." Statements of fact are certain and objective while statements of opinion are uncertain and subjective, often (though not always) signaled by words like "I believe" or "I think." *Omnicare*, 135 S. Ct. at 1325.

In the months following the *Omnicare* decision, lower courts have applied its reasoning to various statements that are *not* preceded by the type of "I believe" signaling language referred to in the opinion, like judgments about the interpretation of clinical trial results and loan loss

reserves. *In re Merck & Co., Inc. Sec., Derivative & "ERISA" Litig.*, 2015 WL 2250472, *19-20 (D.N.J. May 13, 2015); *Corban v. Sarepta Therapeutics, Inc.*, 2015 WL 1505693, *6 (D. Mass. Mar. 31, 2015); *City of Westland Police & Fire Ret. Sys. v. MetLife, Inc.*, 2015 WL 5311196, *10 (S.D.N.Y. Sept. 11, 2015).

In this case, the ALJ erred in focusing exclusively on the lack of such signaling language. A statement of legal compliance with a complex lease, containing numerous irrelevant and inapplicable provisions, and containing significant ambiguity (as to occupancy) and discretion (as to coverage ratios) in how covenants are to be calculated undeniably involves a "matter of judgment." Restatement (Second) of Torts § 538A (1977) (a statement of opinion includes those regarding "matters of judgment." It therefore falls within the ambit of *Omnicare*.

C. As A Matter Of Law, ALC Had No Obligation To Disclose How It Was Meeting The Lease Covenants.

The law does not require companies to disclose every basis for a stated compliance judgment or information that may contradict the assertion of compliance. *Zaluski v. United Am. Healthcare Corp.,* 527 F.3d 564, 572 (6th Cir. 2008); *Gallagher v. Abbott Labs.*, 269 F.3d 806 (7th Cir. 2001); *Kushner v. Beverly Enters., Inc.*, 317 F.3d 820, 831 (8th Cir. 2003). Consequently, where a company has a reasonable defense to an asserted breach of a contract or to assertions of non-compliance with laws or regulations, no claim may be premised on alleged undisclosed information about the basis for the opinion or undisclosed information contradicting it. *See, e.g. Zaluski*, 527 F.3d at 574-76; *City of Livonia Emps.' Ret. Sys. v. Boeing*, 711 F.3d 754, 758-59 (7th Cir. 2013).

The ALJ improperly viewed this as a "misrepresentation" case rather than an "omission" case. (Dec. 50.) The Decision thus erred in viewing the case as being outside of this line of precedent. The ALJ compounded this error by then reaching the opposite conclusion in

discussing materiality, holding that ALC made material misstatements because ALC failed to disclose to investors that it had deviated from its normal occupancy calculation methodology. (Dec. 64.)

IV. The Division Failed To Establish That Bebo Acted With The Requisite Level Of Scienter To Support A Fraud Claim.

Proof of scienter, defined as "a mental state embracing intent to deceive, manipulate, or defraud" purchasers or sellers of securities, is required for a violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12, 213-14 (1976). Because the challenged statements involve matters of opinion and judgment under *Omnicare*, and because they involve disclosures of forward-looking and "soft" information, the Division was required to prove that Bebo knowingly lied about ALC's compliance with the Lease. *See supra* Sec. III.A.; *see also Boeing*, 711 F.3d at 759; *Ind. State Dist. Council of Laborers & Hod Carriers Pension & Welfare Fund v. Omnicare, Inc.*, 583 F.3d 935, 945-46 (6th Cir. 2009).

A. The ALJ Ignored The Context In Which ALC And Ventas Entered Into The Employee-leasing Agreement And The Effect It Had On Bebo's Scienter.

The ALJ disregarded undisputed evidence of the context in which the two companies and Bebo operated in early 2009. Thus, he ignored facts establishing that:

- The eight CaraVita Facilities constituted a very small part of the overall business of both Ventas and ALC from both an operational and economic standpoint. (Ex. 2187 at 6-7; Ex. 2112 at 8; Tr. 296-97.)
- In 2008, ALC and Ventas reached informal agreements about the interpretation of ambiguity in the occupancy and coverage ratio covenant definitions. These were reached without formal lease modifications, and Ventas acknowledged that none was required.[13] (Tr. 325, 329-30, 336-37, 341-46, 3984-85; Exs. 1986 at 130, 1988-89, 1992-94, 2002, 2002A.)

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[13] Similarly, in late 2009, when the economic recession was still severely affecting Ventas, ALC and Ventas resolved an alleged default related to ALC's receipt of license revocation notices from Alabama regulators simply

- In 2009, Ventas' business was severely affected by the Great Recession and Ventas told Bebo and the public at large that its primary goal, and the purpose of the financial covenants, was to maintain its stream of rental payments. (Tr. 285-94, 311-14, 460-61, 4047-49; Exs. 2109 at 4, 7, 2106 at 32-33, 40, 2069, 2070.) Because ALC never presented a risk of non-payment, Bebo reasonably construed silence as agreement under the circumstances. (*Id.*; Tr. 315, 459, 950, 3957-58, 3961-63, 3985-87.)

- This type of informal and flexible approach to covenant compliance was consistent with industry practice during that time period, and lessors almost never take actions to enforce remedies for financial covenant defaults. (Ex. 2185 at 11; 3322 at 11; Tr. 3567-69, 3574, 3634-35.)

In addition, Ventas never defaulted a tenant under any lease on the basis of violations of the financial covenants alone, and Bebo was not aware of *any* instance where *any* landlord pursued a default and remedies solely as a result of a financial covenant violation. (Tr. 379-81, 4047-51.) Even with respect to ALC, the key Ventas witness testified that he understood ALC defaulted between 2009 and 2012 (prior to the lawsuit) and Ventas just "monitored" the situation until ALC was "out of the woods." (Tr. 282.)

B. No Scienter Where Ventas Agreed To Permit ALC To Pay For Rooms For Personnel With A Reason To Go To the CaraVita Facilities.

1. Events prompting the phone call with Solari on January 20, 2009 (the "Solari Call").

A declining economy and resulting drops in occupancy at the CaraVita Facilities resulted in discussions at ALC Board meetings in late 2008 about the implications of non-compliance with the Lease's financial covenants (Ex. 1204), and a meeting among Bebo, Buono, Cafaro, and Solari in December 2008 to discuss how ALC and Ventas might work together through the Great Recession.

Around the same time, Bebo learned that ALC actually had a handful of employees living at the CaraVita Facilities, as hold-overs from the predecessor operator of the Facilities. ALC did

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through a phone call and an email. (Tr. 295-96, 375-76; Exs. 1169, 1231, 2034.) Ventas had issued a notice of default at this time, but otherwise took no action to enforce its remedies under the Lease.

not realize this until it terminated one of them in late 2008, and needed to determine whether it was necessary to evict the employee. (Tr. 1883, 3993-94.)

ALC and Bebo also believed that these employees were included in ALC's occupancy and coverage ratio covenant calculations for 2008 and in reporting by the prior operator. (Tr. 1884-86.) Consequently, in December 2008 or January 2009, Bebo, Buono and Hokeness (ALC's internal auditor) met with ALC's general counsel, Fonstad, to discuss more generally the permissibility of the inclusion of employees in the covenant calculations. (Tr. 1307, 1888-89, 3046-47.)

ALC always had a policy of having employees stay at ALC's facilities (including Ventas') when they travelled to them on business. (Tr. 1551, 2966-67.) This included regional management staff, facilities management staff, and marketing, information technology, and finance personnel. (Tr. 1306, 1551.) To save costs, these employees would stay in a vacant room at the facility instead of a hotel.

2. On the Solari Call, Ventas agrees ALC could pay for apartments for people with a reason to go to the CaraVita Facilities.

(a) Bebo's testimony about the call.

After discussions internally about how to proceed in light of employees previously being included in the covenant calculations, ALC decided to discuss two principal matters during the Solari Call: increasing the performance of the Facilities by (a) partnering with a hospice company, and (b) ALC paying for apartments for employees or others with a reason to go to the Facilities. (Tr. 3997-99.) As described below, Bebo was the only witness with a specific recollection of what occurred on the 30 minute call, which took place on speakerphone in Bebo's office. (Tr. 4002.) Bebo, Buono and Fonstad participated from Bebo's office. (Tr. 1902.) Solari was the only announced participant from Ventas. (*Id.*)

During the call, Bebo told Solari that ALC had identified a few employees who had been renting units at the CaraVita Facilities that carried over from the prior operator. (Tr. 1903.) Solari indicated he was not aware these employees had been living at the Facilities and included in the covenant calculations, but did not think it was a problem. (Tr. 1903-04.)

At that point, Bebo described ALC's desire to initiate a broader employee-leasing arrangement whereby ALC would pay for units that would be available in the CaraVita Facilities for people who would have reason to go there. (Tr. 1904-05, 1907-08.) Bebo made clear that ALC would not be tracking the whereabouts of the employees. (Tr. 1907-08.) On the call, Solari agreed that these units could be included in the covenant calculations for both occupancy and coverage ratio. (Tr. 1908.)

Bebo asked Solari a question to the effect of, "Do you care how many?" Solari stated he did not care. (Tr. 1909.) Bebo's missing hand-written notes of the call confirm this, according to witness testimony. (Tr. 3273-74.) They discussed the rate at which ALC should pay for the apartments, and Solari told Bebo "that it should be, like, an arm's-length, third-party transaction, and it would be at the market rate." (Tr. 1908-09.)

(b) Buono's conduct and testimony corroborated Bebo's account and the ALJ erred in relying on Buono's current version of the Solari Call.

During cross-examination, Buono corroborated numerous aspects of Bebo's account of the call. He testified Solari agreed that ALC would pay for apartments to be used by those employees, and Solari expressed no concern about that practice. (Tr. 4656-59.) Of course, Buono could only have that understanding based on the phone call if those matters were discussed.[14]

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[14] The ALJ's reasoning to the contrary is mystifying: "In context, Buono's testimony that it was understood, "based on the January 20, 2009 call," that "the apartment at the [Facility] would be paid directly by ALC" referred to

Buono testified he believed at the time that ALC did have an agreement consistent with Bebo's understanding: "In 2009, my understanding was that Ventas was aware we were going to put employees into the--into the properties, and it was my interpretation of that that--those employees, we would only do that--a reasonable person would only think we'd do that in order to meet covenants." (Tr. 2489-90.) Similarly, in response to questions from the ALJ, Buono acknowledged that from 2009 to 2012 he understood ALC and Ventas had an agreement based on the Solari Call and follow-up email, but his impression has changed based on his interaction with the Division attorneys: "So there's been additional information after that time [May 8, 2012] that would lead me to believe that maybe this [Solari Email] *wasn't as good of an agreement as we would have hoped.*" (Tr. 4645.)

As the Decision acknowledges, Buono's version of events has evolved as he spent more time with Division lawyers (about 60 hours altogether), who inappropriately told Buono that Bebo had "thrown him under the bus" while simultaneously depriving him of the ability to review her transcript. (*See*, *e.g.*, Dec. at 5-6, 20-22, 30-31; Tr. 2434-35, 2490-91.) With no reasoned basis, the ALJ credited Buono's new-found belief that there was no agreement with Ventas, and went so far as to say Buono's credibility was *bolstered* by the numerous times he was impeached. (*Id.*) Thus, the ALJ at once found that Buono repeatedly lied to the Division during the investigation, both under oath and during interviews, and yet, paradoxically, still found Buono to be credible. (*Id.*)

This changed belief only occurred in connection with his settlement on favorable terms and attempt to enter into the SEC cooperation program, where Buono understood he would answer the Division's questions and "offer things to help them." (*See* Tr. 2432-33.) The ALJ's

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Buono's understanding, not to Solari's." (Dec. 31.) The salient point is that this *was* Buono's understanding *at the time*, and it could only be based on what was discussed on the call.

conclusion that Buono's new-found belief was more credible because it tended to be inculpatory (Dec. 30) ignores the fact that he was admittedly trying to provide information implicating Bebo in order to obtain favorable treatment from the government.

Most importantly, however, Buono's testimony on direct was wholly inconsistent with how he acted from 2009 through 2013. Throughout that time period he acted consistent with the belief that there was an agreement with Ventas to count rooms in the covenant calculations that ALC paid for employees and others to use in assisting with facility operations. (*See generally* Tr. 2390-2545, 2667-2756.)

(c) The ALJ's reliance on Solari for the substance of the call was faulty.

Solari had virtually no recollection of the substance of the January 20 call. In fact, on several occasions prior to the Division's investigation, he told others he had no recollection of the call and could not dispute Bebo's version of it. (Tr. 449-52; Tr. 3480; Ex. 1879 at 4 ("He was unable to deny the Bebo representation of his approval.").) His trial testimony about the 30-minute call was general and non-specific. (Tr. 414, 450.)

Despite this, the ALJ erroneously adopted Solari's two-sentence recollection of the call combined with the speculative testimony of what he "would have" done or said in its entirety. (Dec. 5.) Conversely, he rejected Bebo's detailed recollection believing that no one could remember that type of detail years later. (Dec. 24.) Putting aside the documentary evidence and testimony of other witnesses that corroborates key details of Bebo's recollection, there are other reasons why Bebo would have a detailed recollection and Solari would not. Bebo had to explain what occurred on the call numerous times from 2009 to 2012—to Board members, other ALC employees, ALC's independent auditors Grant Thornton LLP ("GT"), outside counsel, Milbank, and others. Solari, however, was laid off from Ventas (along with 10% of the entire workforce)

only a few months after the call and never had to think about it again until years later. Moreover, Solari had incentive to remember the call the way the government wanted him to.

The ALJ's reliance on what Solari "would have" done was similarly impermissible. (Dec. 29.) In light of Solari's failed memory of this telephone conversation and virtually every other pertinent discussion with ALC personnel (Tr. 413, 446-51, 456-59), his recitation of the denials scripted by the Division with respect to various aspects of Bebo's recollection of the call regarding what he "would" have done or said was speculative and should have been given no weight rather than the dispositive weight the ALJ afforded it. What he "would" have done based on Ventas' routine practice and his position in the organization is irrelevant, as the ALJ established as law of the case when it quashed Bebo's subpoena to Ventas.

Finally, the ALJ erroneously found that Solari had no motive to be biased against Bebo.[15] (Dec. 29-30.) The ALJ ignored testimony that Solari and Ventas discussed conspiring to terminate the Lease with ALC so that Solari's new employer could take over the operations of the CaraVita Facilities. (Tr. 368; Ex. 258.)

(d) The ALJ's factual conclusions about what was said on the Solari Call were erroneous and illogical.

Contrary to the evidence presented at trial, the ALJ determined that "[t]he participants [on the Solari Call] discussed two topics: the leasing of units to a hospice company, and whether certain ALC corporate employees, while traveling to a Facility, could stay in vacant Facility units instead of staying in a hotel." (Dec. at 6.) However, it was undisputed that, *prior to the call,* ALC already had employees staying at facilities when they traveled to the area. The only

[15] The ALJ also somehow found that Solari's credibility was of little significance, despite crediting his version of the call in its entirety. (Dec. 29-30.)

inference to be drawn from that fact is that ALC did not believe that approval from Ventas was necessary for merely having employees stay at the facilities.

Rather, the impetus for having the Solari Call was to discuss whether Ventas objected to the historical inclusion of employees living in the facilities for covenant calculations and whether ALC could pursue broader employee-leasing. Even the Decision acknowledges this at some level. (*See* Dec. at 5 (noting prior discussions with Fonstad about including employees in the covenant calculations).) Indeed, the very purpose of Fonstad's January 19 email was to assess whether this type of practice could be permissible under the Lease. (Ex. 1046.)

The Decision leaves a host of basic questions unanswered, because it is inconsistent with what actually happened. Why would ALC contact Ventas about an established company-wide practice that no one believed Ventas had to approve? Why would Bebo depart from the pre-determined plan of asking Ventas if ALC could include individuals in the covenant calculations, as the prior owner had? If the call went how the ALJ determined, why would Bebo have prepared the final email so differently and risk challenge from Ventas? Why involve Buono and Fonstad on the call if she intended to proceed differently than planned?

(e) The ALJ erred when he concluded that Fonstad did not participate on the Solari Call.

The ALJ erroneously found that Buono, Bebo, and Solari participated on the Solari Call without Fonstad, which tainted his entire analysis of what happened after the call and Bebo's scienter generally. (*See* Dec. 5, 20.) The ALJ's finding that Fonstad was absent is rebutted by the sworn testimony of three other witnesses besides Bebo who place Fonstad in Bebo's office during the call. (Tr. 2343, 2781-82, 2939-40, 3217-18.) Even Division witness Buono testified

under oath during his investigative testimony that Fonstad was present for the Solari call; although, he conveniently could not recall that fact at the hearing. (Tr. 2343, 2781-82.)[16]

Other factual findings about Fonstad and the Solari Call were simply illogical. For example, the ALJ concluded that whether Fonstad was on the call was "immaterial" because Fonstad could not remember any substance of the call. (Dec. 29.) Of course, it matters if ALC's general counsel was involved because it is important to Bebo's subjective belief about the propriety of the employee-leasing agreement, and explains why it was appropriate to rely on the Solari Email rather than a letter signed by Ventas.

3. Bebo sent a February 4, 2009 confirmatory email to Solari (the "Solari Email") regarding employee-leasing.

After hanging up with Solari, Fonstad agreed with Bebo and Buono that the parties had come to an understanding of ambiguous Lease terms and that no formal notice or modification was required. (Tr. 1924-25, 1936.) In Buono's words, Fonstad agreed that including employees in the covenant calculations was "kosher." (Tr. 4651-53.) They then left Bebo's office and discussed the call with ALC's head of sales and marketing, Kathy Bucholtz. (Tr. 2940-41, 4027-29.) According to Bucholtz, they informed her that Solari had agreed that ALC could "count employees in the occupancy." (Tr. 2940-41.)

Buono and Fonstad then took the lead in preparing a follow-up email to Solari. (Tr. 1931-32, 2354, 2468, 2756-57; Ex. 1320 and 1320A.) They prepared the draft, sent it to Bebo, and then discussed it among themselves and with Bucholtz. (Tr. 1931-32, 2951-52.) Bucholtz stated the group discussed the belief that Solari agreed that units used for "a person that

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[16] Buono also told the Division during an interview that "[he] was with Bebo on the Call and Eric [Fonstad] was in the room during the call." (Ex. 2122 at 2.) Emblematic of Buono's molded testimony in favor of the Division, in response to questioning on cross-examination about this point, he stated, "No matter what you do or say, I'm not going to remember if Eric [Fonstad] was in that room." (Tr. 2182.)

had a reason to go to the property" could be included in the covenant calculations. (Tr. 2952-53.)

Consistent with the Solari Call, the Solari Email mostly covered the hospice proposal. (*See* Tr. 1914; Ex. 1334.) One paragraph addressed employee-leasing. (Ex. 1334.) It stated that ALC was "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." (*Id.*)

The Decision acknowledges that "this language could be read as notice that ALC intended to include employees in the covenant calculations." (Dec. 21) However, despite also concluding that the email is "the most reliable evidence of what the call participants discussed, and any agreements they reached" (*id.* at 20), the ALJ somehow concluded there was no agreement on the Solari Call and the email constituted a proposal that Ventas appropriately ignored (without telling anyone at ALC). (Dec. 5, 22.)

The ALJ referred to two reasons why the email does not mean what it says. Neither withstands scrutiny.

(a) The ALJ's analysis of the email was flawed.

First, the ALJ asserted that Bebo did not understand the Solari Email to convey an agreement to include room rentals related to employees in the covenant calculations but rather conveyed a mere proposal. This is belied by the text of the email itself, which discusses a "confirmation" of employee-leasing, contrasted with the "potential" hospice proposal which is described as an "exciting opportunity." (Ex. 184.)

The ALJ also focused on the absence of specific reference to the financial covenants in the Solari Email. But even Buono testified, "there would be no other reason to put them in the

houses other than to put them in the calculations," and he "made that assumption from the -- from the call [with Solari], that they wouldn't -- why would we do it otherwise is the question." (Tr. 2487-88.) And the Ventas witnesses *did not* testify they failed to respond to the email because it did not refer to the covenant calculations. Timothy Doman, head of asset management, testified Ventas disregarded the email because it was not a "formal request," not because he could not tell from the email whether those rentals would be included in the covenant calculations. (Tr. 252-56.)

Similarly, the ALJ erroneously found that Bebo could have been more articulate about including employees in the covenant calculations, contrasting the additional specificity set forth in the email related to the hospice proposal. (Dec. 22.) However, the same hospice language the ALJ cites does not reference covenant calculations, even though ALC indisputably was making that proposal to increase occupancy and cash flow of the facilities for covenant calculation purposes.

The ALJ stressed the differences between Fonstad's initial draft template appended to his January 19 email regarding employee-leasing and the Solari Email.[17] (*Id.* at 21-22.) The ALJ's reasoning ignores the undisputed fact that Buono and Fonstad wrote the Solari Email, and both attended the Solari Call. The ALJ partially recognized the role of Buono *and* Fonstad with regard to drafting this email, but still held Bebo accountable for the language ALC's CFO and general counsel chose. (*See* Dec. 6, 21.) Although the ALJ was correct that Bebo had ultimate authority over the Solari Email because she sent it, she relied on counsel to prepare the email and

[17] Actually, in contrast to the ALJ's adverse findings, the difference in language of these documents indicates that Bebo's version of the call was accurate. Mr. Fonstad's template email discussed a "limited" number of employees that would be used by ALC and that language was removed from the final 2009 email that Fonstad helped draft. (*Compare* Ex. 1046 *with* Ex. 1334.) The absence of this language in the draft Solari Email likely means that Mr. Fonstad was prompted to remove the language because the parties discussed the matter and Solari indicated that he did not care about the number.

the ALJ failed to account for the significance of the fact that Fonstad and Buono—two participants to the call—drafted it.

(b) Ventas' unexpressed subjective belief about the email is irrelevant.

Second, the ALJ determined that the email does not mean what it says because Ventas did not view it as confirming ALC's intent to include employees in the covenant calculations. This is flawed for two reasons. What Ventas subjectively believed or internally discussed is irrelevant to the analysis. Only what Ventas conveyed (or did not convey) to Bebo is significant. And Ventas conveyed agreement to ALC's confirmation of room rentals to employees through its words and conduct.

The ALJ's contrived and biased reasoning on this point is revealed by the simple and critical fact regarding how many times Ventas responded to the Solari Email. The Decision falsely states that Solari's initial response about an asset manager following up with her was "the only follow up" by Ventas to the Solari Email. (Dec. 6.) In fact, the asset manager did follow-up in writing with Bebo. He asked to set up a phone call to discuss the hospice *proposal*, but his response was silent with respect to ALC's *confirmation* of its rentals of rooms related to employees. (Exs. 1343, 3377.)

Based on these two emails, Bebo was aware that *every senior executive and key Ventas employee with direct responsibility for the CaraVita Facilities and the Lease (who were copied on the emails) was aware of ALC's confirmation of the company renting rooms related to employees*. (Exs. 1335, 3376; Tr. 191-92, 452-53 (describing roles and responsibilities).) No one from Ventas ever asked any questions or raised any concerns about the employee-leasing arrangement described in the Solari Email. (Tr. 255-56, 352-54, 427-29.)

Subsequently, the asset manager set up a call in response to his February 13 email, involving multiple representatives from ALC and Ventas. (Tr. 4044-45.) During the call, the parties went through the Solari Email point-by-point with respect to the hospice issue. (*Id.*) However, Ventas again raised no questions, issues, or concerns about ALC's confirmation of its notification of rentals related to employees. (*Id.*) Bebo honestly and in good faith believed that ALC had an agreement with Ventas to use employee-leasing to meet the covenants based Ventas' lack of objection in two written responses to the Solari Email as well in subsequent discussions. (Tr. 4044-45; 1937-38.) Bebo's subsequent conduct and statements while at ALC were consistent with that belief.

C. No Scienter Where Bebo Consulted With And Relied On The Advice Of Counsel.

Generally, disclosing pertinent facts to legal counsel negates an inference of scienter. *Howard v. SEC*, 376 F.3d 1136, 1147-49 (D.C. Cir. 2004). Moreover, relying on the advice of counsel as to whether a contemplated course of action is legal can be a complete defense. *See United States v. Benson*, 941 F.2d 598, 614 (7th Cir. 1991); *SEC v. e-Smart Techs., Inc.*, 2015 WL 583931, 6 (D.D.C. Feb. 12, 2015) (citing *Zacharias v. SEC,* 569 F.3d 458, 467 (D.C. Cir. 2009)); *SEC v. Harwyn Indus. Corp.*, 326 F. Supp. 943, 955 (S.D.N.Y. 1971).

1. Fonstad's January 19, 2009 email advised that employee-leasing would be permissible if Ventas approved.

After Fonstad participated in late 2008 internal discussions about ALC employees living at the CaraVita Facilities and the potential for ALC to pay for apartments to be available for employees and family members as a way of meeting the covenants (*see* Tr. 1307, 1318, 1550-51), Fonstad provided his preliminary analysis of issues pertaining to the Lease in a January 19, 2009 email. Lost on the ALJ was the basic conclusion of the email: he advised that ALC could conduct employee-leasing if Ventas approved.

Moreover, the undue importance placed on the template appended to the email is a strawman because:

- Fonstad never advised that the then-contemplated arrangement of renting units for employees would require a formal modification. Both his email and the template letter accompanying it advised Bebo that ALC seek "confirmation of [ALC's] interpretation of the lease" or send a letter "confirm[ing] the understanding we reached about the interpretation of certain terms of the [Lease]." (Ex. 1046)

- Fonstad never advised a formal notice under Section 33 of the Lease was required. (*Id.*)

In the end, the Solari Email confirmation and acknowledgement of its receipt by Ventas—in writing—achieved the same result as the contemplated template letter (as Fonstad no doubt agreed since Bebo sent him both the Solari Email and Ventas' response).

2. Fonstad's continued involvement and advice.

It is indisputable that Fonstad continued to be involved in every step of ALC's decision to pursue employee-leasing. For example:

- On February 5, 2009, Fonstad received the Solari Email from Bebo after it was sent to Ventas, reviewed it, and printed it for his records. (Ex. 1171; Tr. 1529-31, 1558-59.)

- He received Ventas' response to the Solari Email, reviewed it, and printed it for his records. (*Id.*);[18]

- He chaired several Disclosure Committee meetings where the challenged disclosures were discussed in light of the Solari Email and including employees in the covenant calculations, including one only eight days after the Solari Email. (Ex. 124.)

- Like Bebo, ALC's director of financial reporting and internal auditor relied on Fonstad's lack of objection to the practice and ALC's disclosure in meeting their obligations. (Tr. 3054-55, 3689-90, 3703-04.)

Finally, on February 19, 2009—two weeks after the Solari Email and six days after the Disclosure Committee meeting where it was discussed—Fonstad *approved ALC's affirmation of*

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[18] Despite knowing he received these emails, Fonstad falsely testified that he had no idea one way or another whether the phone call on January 20th ever occurred. (Tr. 1507, 1555-56.)

compliance, the same disclosure that the Division and the ALJ contends constituted a misrepresentation. (Ex. 1057; Tr. 1580-82; *see also* Tr. 1929-30.) Bebo relied on his approval. (Tr. 1929-30.)

D. No Scienter Where Bebo Understood ALC Disclosed The Basic, Key Facts To ALC's Outside Auditors.

The ALJ erred as a matter of law in not concluding that the reliance on outside auditors mitigated the scienter finding and precluded a securities fraud violation. *See SEC v. Snyder*, 292 F.App'x 391, 406 (5th Cir. 2008); *SEC v. Caserta*, 75 F.Supp.2d 79, 94 (E.D.N.Y. 1999) ("Good faith reliance on the advice of an accountant or an attorney has been recognized as a viable defense to scienter in securities fraud cases.").

Here, GT and its engagement partners were aware of the basic, important facts surrounding the employee-leasing arrangement from the outset:

- GT knew employee-leasing was premised on a conversation with Ventas followed by a confirmatory email. When GT asked for documentation of the agreement with Ventas, ALC provided it, and GT was satisfied. (Exs. 1379, 1379A.)
- Upon GT's request, ALC provided GT lists of names for the covenant calculations, and part of GT's general practice was to review the details and look for unusual items. (Tr. 3341-42.) Many of those lists included the same employees at multiple locations for the same quarter and GT did not find that troublesome. (*See* Ex. 3315; Tr. 3398, 3404 (stating he understood employees "may have needed to have rooms available to them at various locations.").) The ALJ disregarded Robinson's clear testimony on this issue.
- GT understood that ALC, not employees, paid rent. (Tr. 3404-05.)
- GT knew that ALC would have failed the covenants without the employees. (Tr. 3514.)
- GT made site visits to several of the CaraVita properties for audits, including in 2010. (Tr. 3338-40.)
- GT tested the journal entries associated with employee-leasing; the engagement team knew the purpose of and tested "the 997 activity in the elimination of intercompany revenue." (Tr. 3351-53; Ex. 1679.)

- By the 2011 audit, GT knew that Ventas was not receiving the occupancy reconciliations setting forth the rooms related to employees. (Tr. 3406-07, 3418-20; Exs. 1824, 1824A.)

The Decision also specifically found that Bebo misled GT into believing there was a formal written agreement or modification of the Lease in management letters and in a conversation with a GT audit partner, Melissa Koeppel. (Dec. 33-34.) However, Koeppel testified the exact *opposite* of the ALJ's conclusion that Bebo told her there was a written modification to the Lease. (Tr. 3317.) Moreover, other evidence established GT knew there was no formal documentation governing employee-leasing. Rather, the practice was based on a phone call and a confirmatory email arrangement where clarification of an ambiguous Lease term was agreed upon. (Exs. 1685 at 5, 1696 at 7-8; Tr. 3317, 3428-29.)

E. No Scienter Where Bebo Disclosed The Basic, Key Facts About Employee-Leasing To ALC's Board.

1. The ALJ's findings about the importance of Board knowledge were erroneous.

Contrary to what the ALJ found (Dec. 42), Board knowledge of employee-leasing undermines a finding of scienter. While there is no established "Board approval" defense, it certainly is relevant evidence that undermines scienter and supports a finding that Bebo acted in good faith. Put simply, someone in Bebo's shoes would not tell the Board anything if she was trying to commit fraud.

Similarly, the ALJ's reasoning that the failure to inform the Board of every detail adds to an inference of scienter is flawed. (Dec. 41-42.) This is particularly true in light of the ALJ's finding that ALC's disclosures were false by the mere fact that it included employees in the covenant calculations without a formal modification of the Lease. Consequently, under the ALJ's analysis, whether the Board knew every detail about employee-leasing is irrelevant. They certainly knew that the Lease had not been modified and that ALC was meeting the covenants

through employee-leasing. In addition, the ALJ's reasoning here demonstrates how he stretched the evidence to be adverse to Bebo to reach a pre-ordained outcome, first faulting Bebo for bringing the issue of employee-leasing to the Board in the first place (Dec. 23), then faulting her for not providing enough details (Dec. 42), then faulting her again for providing all of the occupancy data to the Board (Dec. 43-44).[19]

2. The ALJ's fact-finding about Board knowledge was erroneous.

The ALJ's findings with regard to Board knowledge and approval were inconsistent, contrary to the record, and clearly erroneous. Acknowledging that witnesses who testified on this subject gave "strikingly inconsistent testimony" and the documentary record was also conflicting, the ALJ ultimately threw up his hands and concluded that "the Board as a whole did not know prior to March 6, 2012, that employees were included in the covenant calculation process." (Dec. 42.) Without analysis, the ALJ dismissed *en masse* the conflicting evidence as "not credible or is accorded little weight." (*Id.*)

The ALJ erred by dismissing, without any basis, a host of credible corroborating testimony, and circumstantial documentary evidence that established that the Board as a whole and specific Board members, including as ALC's chairman, vice chairman, and Audit Committee chair knew ALC was meeting the financial covenants through the use of employee-leasing because Bebo repeatedly told them about that process.

(a) GT discussed employee-leasing with the Board multiple times.

GT's engagement partners, Koeppel and Robinson, each testified that they spoke to the Audit Committee—which was typically attended by all Board members—about employee-leasing. In mid-2009, Koeppel briefed the Board on employee-leasing, telling them that

[19] More troubling still, the ALJ found that Bebo should have assumed the board would not read the detailed financial materials provided ahead of the meetings. (Dec. 44.) This sends the wrong message about proper corporate governance.

"management had entered into an arrangement with Ventas to include in the covenant calculations employees who had stayed at the properties for a business purpose." (Tr. 3328-30.) No one was surprised (*id.*), because Bebo had already disclosed that to them. She revisited the issue with the Board and in her separate meetings with the Audit Committee chair on subsequent occasions. (Tr. 3335-38, 3440.)

Like Koeppel, Robinson discussed with the Board the fact that the company would not be meeting the Lease covenants without included rooms for employees in the covenant calculations in early 2011 and discussed similar matters with the Audit Committee chair. (Tr. 3430-31, 3435-36, 3514-17, Exs. 1913, 1913A.)

Buono confirmed GT's testimony. He stated that the chair of the Audit Committee, Malen Ng, "knew about employee-leasing" because Robinson discussed it with her. (Tr. 2417-18.) He specifically recalled that in a meeting to discuss Q3 2009 Ng told him "Robinson had discussed employee-leasing, that we were renting rooms to employees, and that was part of how the covenants were being made." (*Id.*; *see also* Tr. 2523-24; Ex. 1115.) He also told the Division that "Robinson did discuss [with the Audit Committee] it would be better if there were actually paying customers at the properties" and that two Board members "knew long before this about the employee adds." (Ex. 2122 at 7.)

The ALJ ignored Koeppel and Robinson's unambiguous testimony that they discussed employee-leasing with the Board because there was no specific document memorializing the details of these discussions. (Dec. 43.) However, the ALJ did not explain why the GT witnesses—who he found to be credible when providing unfavorable testimony about Bebo—lack credibility here. There was no basis to reject their testimony.

(b) Other evidence corroborated Bebo's accounts of Board knowledge.

In summary form, the Board knowledge-related evidence established the following:

- Buono confirmed Bebo's account of the Board instructing management to meet the covenants through employee-leasing at the outset in February 2009. (Tr. 1958-66, 2393-96, 4029-32, 4204; Exs. 2092, 2094, 2117 at 1.)
- Bebo discussed details about employee-leasing at the Q3 2009 Board meeting, which was corroborated by Buono, who also confirmed that ALC director Buntain instructed Bebo and Buono to add additional employees for a "cushion" in the financial covenant reporting. (Tr. 1372, 2023-26, 2392-93, Ex. 2117 at 6.)
- Bebo and Buono discussed the employee-leasing program with the Board again in 2011 when evaluating ALC's response to an SEC comment letter (Tr. 2108, 4246, 4249-52, 4629-31, Exs. 86 at 46, 1048), which was confirmed by an ALC Board member (Tr. 1452-54).
- ALC's Vice Chairman testified Buntain made a similar "cushion" comment in a Fall 2011 Board meeting. (Tr. 2816-17.)

F. No Scienter Where ALC's Disclosure Committee Considered Employee-Leasing And Determined ALC's Statement Of Lease Compliance Was Appropriate.

As part of its SEC disclosure process, ALC convened a Disclosure Committee to meet its obligations. (Ex. 1919 at 3; Tr. 1567-68.) Specifically, the Disclosure Committee was tasked with identifying and reviewing ALC's disclosures and making recommendations to senior officers like Bebo, regarding changes or additions. (*Id.*) Bebo had no role in or influence on the Disclosure Committee, as she was not a member of it. (Tr. 3704-05.)

Beginning with the February 13, 2009 meeting—only nine days after the Solari Email—and at each quarterly meeting in 2009 thereafter, the Disclosure Committee discussed how ALC was meeting the financial covenants, which had been "clarified" through the Solari Email so that ALC could include rooms related to employees in the covenant calculations. (Tr. 3702; Exs. 124 at 3; 125 at 4; 126 at 4; 1159B at 4.) The minutes of two of the 2009 Disclosure Committee meetings state:

> Lease covenants continue to be monitored. Adjustments to calculations for Ventas covenant continue to be processed. There has been no relief in covenants and currently there are no on-going negotiations. With respect to Ventas lease[,] correspondence between ALC and Ventas has occurred whereby the covenant calculations have been clarified as to census. The Company affirmatively asserts compliance for Q2. No lease covenants violated.

(Exs. 126 at 4; 1159B at 4.)

No one associated with the committee raised a concern about the practice or a need to modify ALC's disclosure about the Ventas Lease in its Commission filings.[20] (Tr. 1592-95, 3100-04, 3699-3704, 3707, 3711.) Amazingly, the ALJ disregarded this evidence simply because it was provided to the committee by Buono and he "now believes that Ventas did not have the understanding he said it did." (*Id.*) But whatever Buono "now believes" does not change what was discussed at the time of the committee meeting, and should not affect the important impact of Disclosure Committee consideration on the falsity and scienter analysis.

The ALJ also found the Disclosure Committee to be "immaterial" because Bebo signed the reports and, thus, made her own misrepresentations. (Dec. 55.) But this ignores the purpose of the committee, which was to assist Bebo in ensuring that the representations were accurate. Commission approval of the ALJ's reasoning would signal to public companies that Disclosure Committees serve no purpose and management cannot rely on them.

G. Other Factors Weigh Against A Finding Of Scienter.

In summary form, they are:

- Bebo received no personal benefit from the purported fraud and had no motive to commit fraud. This weighs against scienter. *Plumbers & Pipefitters Local*

[20] Similarly, after Ventas sued ALC and ALC discussed the employee-leasing arrangement with Quarles in April 2012, neither Quarles nor any other third party recommended that ALC should modify its disclosure in its Q1 Commission filings or otherwise disclose how it was meeting the financial covenants through the use of apartments that ALC paid for employees and others to use. (Tr. 4483-84, 3723-26; Ex. 2058, 2058A at 18.) By the time of the reasonableness opinion and preparation of these draft filings, Quarles lawyers were aware that 70 to 90 units for employees were being utilized for the covenant calculations and that ALC was paying for them through intercompany revenue. (Ex. 3684.)

Union 719 Pension Fund v. Zimmer Holdings, Inc., 679 F.3d 952, 956 (7th Cir. 2012). The ALJ's reliance on a supposed motive to avoid reputational damage or discipline to support an inference of scienter is contrary to the law. *See, e.g. Pugh v. Tribune Co.*, 521 F.3d 686, 695 (7th Cir. 2008); *Novak v. Kasaks*, 216 F.3d 300, 307-08 (2nd Cir. 2000); *McIntire v. China MediaExpress Holdings, Inc.*, 927 F.Supp.2d 105, 120 (S.D.N.Y. 2013) (collecting cases).

- Bebo's actions on May 3 reflect her good faith toward investors and clear desire that they not be misled. (Tr. 2717-22, 4485-92; Exs. 354, 2081.)
- After a thorough internal investigation, Milbank concluded Bebo was "open and transparent" with GT and possessed "no ill intent." (Tr. 3483-84; Ex. 1879 at 6.)
- Milbank concluded that Bebo acted reasonably in relying on Ventas' silence in response to the Solari Email and that no formal modification of the Lease was necessary. (Tr. 3481; Ex. 1879 at 4-5.)
- The Board agreed with Milbank, and represented to GT at the November 2012 Audit Committee meeting that they were not aware of any "indications of fraudulent activities" at any time during 2012 and affirmed the appropriateness of ALC's internal controls for that time period. (Tr. 3467-71; Exs. 1035 at 3, 1701.) They took no adverse employment action against Buono and gave him a raise and bonus. (Tr. 2619-20, 2782-83.)

H. The ALJ Misconstrued Subsequent Discussions With Ventas And Incorrectly Found That Bebo Did Not Believe ALC Reached An Agreement With Ventas.

In concluding that Bebo did not subjectively believe she had reached an agreement with Ventas, the ALJ principally relied on ALC's negotiations with Ventas about the potential purchase of two New Mexico facilities from Ventas in the weeks following the Solari Email where ALC sought limited covenant relief. (Dec. 23-24.) However, the ALJ misstated the record, relied on double-hearsay, and intentionally conflated the limited relief from coverage ratio covenants ALC sought with covenant relief generally.

The ALJ principally relied on a February 17, 2009 ***internal*** Ventas email purporting to relay a conversation Solari had with Buono and Bebo. (Dec. 22-23 citing Ex. 188.) The email indicated that ALC hinted at "eliminating the covenants entirely" in connection with the proposed purchase of the New Mexico properties. The Division elicited no testimony about the

reported conversation. The ALJ erred in relying on unreliable double-hearsay as the purported critical piece of evidence about Bebo's subjective belief.[21] *See Hoska v. U.S. Dept. of the Army*, 677 F.2d 131, 138-41 (D.C. Cir. 1982) (holding that in an administrative proceeding uncorroborated hearsay evidence is insufficient to satisfy the government's burden, particularly in the face of contradictory sworn testimony from the respondent or other witnesses).

Moreover, contrary to this unreliable evidence, the documentary evidence and testimony from multiple witnesses at the hearing about this issue confirmed that ALC was seeking relief only from the coverage covenants because Bebo believed there *was an agreement to count units related to employees* but there was still a chance that ALC could fail the coverage covenants despite the agreement. (Exs. 190, 1349, 3380; Tr. 354-55, 432. 2359-60, 2500, 2504-05, 4053-55.)

V. The ALJ Improperly Concluded That "Scheme" Liability Applied To This Case.

The ALJ erred in concluding that "scheme" liability applies in this case, and improperly double-counted violations under subsections of Rule 10b-5. (Dec. 64-66.) First, the ALJ misapplied the Commission's decision in *In re John P. Flannery*, Release No. 3981, 2014 WL 7145625 (Dec. 15, 2014). Under that decision, scheme liability exposes to securities fraud liability those who did not "make" the statement at issue. It does not impose additional liability on a maker of the statement; such additional liability could be imposed in virtually every "maker" case. *See id.*

[21] Contrast this with the rejection of statements inconsistent with Buono and Solari's trial testimony that were made to Milbank and rejection of the Milbank investigation generally. When the evidence was favorable to Bebo, the Decision gave "no weight" to it because it was double hearsay. (Dec. 47.) And despite acknowledging that Milbank's conclusions were based on the interviews of sixteen people from ALC, as well as Solari (through counsel), in 2012, the Decision asserts that the reliability of the investigation "is at best doubtful." (Dec. 47.) The Decision provides no explanation for this, other than the self-serving statement that Milbank was apparently biased and predisposed toward finding no impropriety, citing only *the ALJ's own statements* on the record as support. (Dec. 47 (citing Tr. 667).)

Second, the First Circuit recently overturned the *Flannery* decision in its entirety, and for the very reason that Bebo urged that scheme liability has no role in this case—it does not add anything where the defendant is the maker of the alleged misstatement. *Flannery v. SEC*, 2015 WL 8121647, *1 (1st Cir. Dec. 8, 2015). Because *Flannery* is no longer good law, any violation and sanction imposed based on it must be reversed.

VI. The ALJ Committed Factual And Legal Error In Finding Bebo Misled ALC's Auditors.

The ALJ's finding with respect to the misleading auditors claim pursuant to Rule 13b2-2 appears to be premised on management representation letters that affirmed compliance with contractual agreements generally. (Dec. 70.) For the same reasons set forth above, ALC and Bebo reasonably concluded they were in compliance with the Lease based on the employee-leasing arrangement, and GT was indisputably aware that the Solari Call and Email was the sole basis for ALC's compliance.

Additionally, after a full and complete investigation by Milbank through which GT obtained an even more complete understanding of the manner in which ALC was meeting the covenants, it still concluded that ALC was in compliance with the Lease and did not believe it had been misled. This evidence is highly relevant and was improperly dismissed by the ALJ.

Further, the ALJ erred by imputing to Bebo conduct of other ALC employees and their interactions with GT. (Dec. at 16-17; 34-35.) For example, the ALJ relied extensively on GT's misunderstanding during 2010 and 2011 that Ventas was receiving the same reports with the employee lists that GT was receiving. (Dec. at 34-35.) Yet it was undisputed that Bebo had no direct communication with GT about reporting to Ventas; indeed, she had little direct interaction with the auditors at all after explaining the basic agreement with Ventas. (*See, e.g.* Tr. 3326.) Bebo's knowledge gets imputed to ALC, but the knowledge and conduct of other ALC

employees or executives *may not* be imputed to Bebo. *See Mark I, Inc. v. Gruber*, 38 F.3d 369, 371 (7th Cir. 1994); *Coach, Inc. v. Sapatis*, 27 F.Supp.3d 239, 245 (D.N.H. 2014).

Finally, the ALJ's decision that Bebo intended to mislead the auditors was arbitrary and unsupported.[22] ALC employees testified that Bebo never told them to withhold information from GT or mislead the auditors. And GT witnesses testified they did not believe they were, in fact, misled. (Tr. 3360-61, 3406-07.) As noted, her openness with the auditors was one of the reasons Milbank concluded there had been no wrongdoing on the part of management and GT did not disagree with that assessment.

VII. The ALJ Erred By Concluding Bebo Violated The Exchange Act's Books And Records And Internal Controls Provisions.

To find violations of Section 13 of the Exchange Act, the ALJ based his decision on the occupancy reconciliations/employee lists under the false assumption that they were meant to track actual days and stays of employees at the CaraVita Facilities. They were not. (Tr. 1097-98, 1179-80, 3912-13, 3404, 4008-10; Ex. 1685 at 5; 3507.) In addition, as set forth previously, Bebo did not act with scienter or unreasonably, as required to support a violation. *See United States v. Reyes*, 577 F.3d 1069, 1080 (9th Cir. 2009); SEC Release Notice, No. 17500, 1981 WL 36385 (Jan. 29, 1981).

Moreover, because ALC had sufficient internal controls in place to safeguard against intercompany revenue associated with employee-leasing affecting ALC's public reporting (through the use off-setting entries in the 997 Account), Bebo did not cause a violation of Section 13(b)(2)(B). (*See* Tr. 807-810, 861, 2771-72, 4128-34.)

Finally, the ALJ ignored the fact that GT audited ALC and issued a clean internal controls opinion at 2012 year-end *after* receiving a full report of Milbank's internal investigation

[22] A claim under Rule 13b2-2 requires a showing of scienter. *See SEC v. Todd*, 642 F.3d 1207, 1220 (9th Cir. 2011).

results, including information that ALC booked revenue for employees who went to the leased facilities as well as for employees with a reason to go who did not actually go. (Ex. 2183; *see also* Tr. 1722.) The ALJ also erred in rejecting the importance of GT's audit opinions for year-end 2011 and 2012, dismissing them without any explanation as "self-serving." (Dec. 68.)

VIII. The ALJ Erred In Concluding That Rule 13a-14 Provided A Basis For A Separate And Independent Violation For Liability And Penalty Purposes.

The ALJ erred in finding an independent cause of action for violating Rule 13a-14 and for imposing penalties for those violations. *First*, because there was no underlying falsity in ALC's filings, there can be no violation of Rule 13a-14 either. *Second*, a violation of Rule 13a-14 does not give rise to an independent cause of action. *See, e.g. In re Radian Sec. Litig.*, 612 F.Supp.2d 594, 620 (E.D. Pa. 2009); *In re Huffy Corp. Sec. Litig.*, 577 F.Supp.2d 968, 1020 (S.D. Ohio 2008).

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

The sanctions ordered by the ALJ were erroneous for a variety of reasons, including many of the same reasons discussed above. The ALJ's decision to impose draconian third-tier civil penalties was not supported by the facts or the law. Nor did (or could) the ALJ articulate any reasoned justification for the penalties he imposed or the method he used to calculate those penalties, and he failed to adequately explain (or even attempt to explain) why the Decision departed from Commission precedent when calculating and imposing such draconian monetary penalties or the other sanctions ordered.

A. The Record Does Not Support The ALJ's Imposition Of Third-Tier Monetary Penalties.

The Exchange Act establishes a three-tier system for calculating the maximum amount of any civil penalty, which may be imposed if a Respondent willfully violates the Exchange Act.

15 U.S.C. § 78u-2(a), (b). Only where a respondent's conduct involved fraud or reckless disregard of a regulatory requirement *and* resulted in substantial losses or created a significant risk of substantial losses to other persons, the Commission may impose a maximum third-tier penalty of up to $150,000 for each act or omission constituting a violation of the securities laws. 15 U.S.C. § 78u-2(b)(3); 17 C.F.R. § 201.1004. In addition, before assessment of any penalty, the Commission must find that such an assessment is in the public interest. Section 21B(a) of the Exchange Act requires that the public interest finding support not only the decision to assess a penalty in the first place, but the amount of the assessment as well. *See* 15 U.S.C. § 78u-2(b)(3).

The ALJ ruled that "maximum" third-tier civil penalties were appropriate in this case because Bebo's alleged violations "involved fraud and/or at least reckless disregard of a regulatory requirement, and the resulting harm caused substantial losses to ALC and a significant risk of substantial losses to investors." (Dec. 79.) But for the reasons discussed above, the ALJ's conclusions that Bebo's conduct involved fraud or recklessness were incorrect.

Similarly, the ALJ erred in concluding that Bebo's conduct resulted in substantial losses to investors based only on a decline in ALC's stock price that occurred on May 4, 2012, following the public disclosure of an internal investigation into "irregularities" related to the Ventas Lease. (Dec. 79.) This finding was reliant on speculation and contrary to the actual facts presented at the hearing, as described *supra* Section II.A., and cannot support a finding of a risk of substantial losses to investors. Similarly, for the reasons set forth in Section II.C.3, the alleged fraud did not cause substantial losses to ALC. In fact, the purchase of the Facilities increased ALC's value and ALC's stock went up when ALC announced that it would be purchasing the Ventas properties and booking one-time losses.

There was certainly insufficient evidence to prove the direct causal relationship of any stock decline required under the statute. *See, e.g., SEC v. Platforms Wireless Int'l Corp.*, 2007 WL 1238707, *14 (S.D. Cal. Apr. 25, 2007), *vacated in part on other grounds*, 559 F.Supp.2d 1091 (S.D. Cal. 2008); *SEC v. Pattison*, 2011 WL 723600, *5 (N.D. Cal. Feb. 23, 2011).

B. At Most, Bebo Should Be Subject To A Single Penalty For The Entire Course Of Conduct.

The ALJ's decision to impose such drastic civil penalties was erroneous not only because the factual criteria for civil penalties does not warrant them, but also because the ALJ utilized a method for calculating penalties which effectively punished the same conduct multiple times over and resulted in an excessive monetary sanction.[23] In this respect, the ALJ's decision was both arbitrary and contrary to established precedent.

Although the statute provides that a penalty can be imposed for each act that constitutes a violation of the law, it leaves the precise manner of calculating the violations undefined. Thus, calculation of the penalty varies widely administratively, with this ALJ's formulation of the standard is recognized as the most arbitrary. Jonathan N. Eisenberg, *Calculating SEC Civil Money Penalties*, available at http://corpgov.law.harvard.edu/2016/01/24/calculating-sec-civil-money-penalties/ (Jan. 24, 2016). Federal courts and the Commission have generally imposed one civil penalty where there are multiple violations based on a single course of conduct, such as where the same representation is repeated to multiple investors or in different time periods. *See, e.g., SEC v. Blackout Media Corp.*, 2012 WL 4051951, *2 (S.D.N.Y. Sept. 14, 2012); *SEC v. Rabinovich & Assocs., LP*, 2008 WL 4937360, *6 (S.D.N.Y. Nov. 18, 2008); *SEC v. Save the*

[23] If not corrected, the imposition of these penalties is punitive, disproportionate, and would be a violation of the Excessive Fines Clause of the Eighth Amendment. *See, e.g., In Re F.X.C. Inv'rs Corp.*, Release No. 218, 2002 WL 31741561, *21 (Dec. 9, 2002) ("I conclude that the $100,000 penalties sought by the Division in this proceeding are grossly disproportionate to the gravity of the proven offenses, and thus constitutionally excessive under the Excessive Fines Clause of the Eighth Amendment. That is a matter that justice requires me to consider.").

World Air, Inc., 2005 WL 3077514 (S.D.N.Y. Nov. 15, 2005); *SEC v. Robinson*, 2002 WL 1552049 (S.D.N.Y. July 16, 2002); *SEC v. Lawbaugh*, 359 F.Supp.2d 418 (D. Md. 2005); *In re Raymond J. Lucia Cos.*, Rel. No. 540, 2013 WL 6384274, *59 n.41 (Dec. 6, 2013).

Rather than treat Bebo's acts as a single course of conduct for purposes of calculating penalties, the ALJ departed from this long line of precedent and opted instead to calculate monetary sanctions based not on Bebo's acts, but on the categories of securities violations alleged by the SEC in the OIP (including a "scheme to defraud," which effectively punished Bebo a second time for each of the first three categories of alleged violations because taken together they were part of that "scheme"). And even though Bebo did nothing new in each successive quarter and the alleged "violative acts" remained the same, the ALJ imposed the maximum penalty for each category of alleged violations seven times, for each quarter that passed before the alleged scheme ceased. The obvious effect of this treatment was that Bebo was improperly sanctioned multiple times for the same alleged misconduct.

The only rationale cited by the ALJ to support this method of calculating penalties was that "[c]ounting four units of violation for each quarter prejudices Bebo less than counting the maximum legally available." (Dec. 79.) The ALJ failed to explain what the "maximum legally available" may have been, or why even less prejudicial methods (such as calculation based on one course of conduct) would not have been more appropriate. Nor did the ALJ make any attempt to justify his departure from the long line of cases treating similar alleged securities violations as a single course of conduct for purposes of calculating the maximum available penalty. It is well-established that when the Commission imposes draconian civil penalties, it bears a higher burden of explaining and justifying its decision. *See Steadman v. SEC*, 603 F.2d 1126, 1139 (5th Cir. 1979).

Despite the ALJ's contrary decision, if the Commission determines that a penalty is appropriate, that penalty should be calculated in light of the fact that the representations at issue in this case were unchanged in every public filing and the product of a single course of conduct, rather than multiple independent violations of securities laws.

C. The Public Interest Factors Do Not Support The Excessive Civil Penalties And Permanent Director And Officer Bar Imposed.

Before imposing a sanction, the Commission must consider whether an administrative sanction serves the public interest. To this end, the Commission considers the *Steadman* factors and certain similar statutory factors. *Steadman*, 603 F.2d 1126 at 1140 (5th Cir. 1979); 15 U.S.C. § 78u-2(c). These factors are (1) scienter/egregiousness; (2) harm to others; (3) whether the person was unjustly enriched; (4) scope of previous violations and likelihood of future violations; (5) assurances against future violations/recognition of wrongdoing; (6) deterrence. *Steadman*, 603 F.2d at 1140. Although the statutory tiers determine the maximum monetary penalty available for securities violations, "each case 'has its own particular facts and circumstances which determine the appropriate penalty to be imposed'" within the tier. *SEC v. Opulentica, LLC*, 479 F.Supp.2d 319, 331 (S.D.N.Y. 2007) (quoting *SEC v. Moran*, 944 F.Supp.286, 296-97 (S.D.N.Y. 1996)).

Although the ALJ identified the above *Steadman* factors before reaching his decision on the appropriate sanction to levy, he failed to give meaningful consideration to each of those relevant factors, beyond merely reciting—and then summarily dismissing—most of them. Indeed, although the ALJ correctly acknowledged that "no one factor is dispositive," he apparently concluded that two factors are, declaring that "two factors (egregiousness and scienter) decisively weigh in favor of the heaviest possible sanction." (Dec. 76.) Disregarding

and failing to assess the other factors warrants reversal. *See Monetta Fin. Servs., Inc. v. SEC*, 390 F.3d 952, 957-58 (7th Cir. 2004).

The ALJ also weighed the factors inappropriately.

Scienter/egregiousness. As established earlier, the ALJ erred in finding scienter and placing excessive and unfounded weight on the purported "egregiousness" of Bebo's conduct.

No harm. Nor was anyone harmed as a result of Bebo's conduct, including "the marketplace, shareholders, and Ventas" (as the ALJ concluded). In addition to the reasons that ALC was not harmed, as described earlier, the alleged misconduct did not create liability for default under the Ventas lease. If anything, it was the performance of the company during the recession, not the employee-leasing practices at issue in this case, that exposed ALC to such liability. In fact, to the extent those practices prevented Ventas from pursuing its remedies against ALC earlier, they actually *benefitted* ALC and its shareholders— the accelerated rent payments were reduced by approximately $15 million during that time period. And given that the ALJ's theory is that ALC overpaid Ventas for the CaraVita properties, it remains a mystery how Bebo's conduct harmed Ventas.[24]

No personal enrichment. In addition, the evidence in this case shows that Bebo received no personal benefit from the employee-leasing arrangement at the center of the SEC's allegations, as her annual performance compensation was not affected by compliance or noncompliance with the Ventas lease covenants, and the CaraVita facilities represented only a

[24] The ALJ's reference to the settlement of a shareholder suit is particularly inappropriate. (Dec. 76.) For one thing, the settlement of a lawsuit is not an admission of liability, so the fact that ALC chose to settle the class action does not mean that the suit had any merit and does not indicate that the underlying conduct at issue in the case exposed anyone, including the company or its shareholders, to any risk of loss or liability. Indeed, it is for that very reason that evidence of settlement agreements or negotiations are ordinarily inadmissible in our courts. *See* Fed. R. Evid. 408.

negligible portion of ALC's business and operating income (by the end, ALC was losing money by operating the properties under the Lease).

Indeed, the ALJ specifically acknowledged that Bebo did not benefit financially from her alleged misconduct, but expressly rejected the idea that such a factor should weigh against the imposition of harsh sanctions, concluding: "Bebo's misconduct did not clearly benefit her financially, but it helped her avoid discipline and reputational harm; although this factor does not weigh in favor of a severe penalty, it also does not weigh against it." (Dec. at 79-80.) But despite this conclusory assertion to the contrary, the Commission *has* traditionally treated the lack of unjust enrichment as a factor weighing against harsh sanctions. *See, e.g., In Re F.X.C. Inv'rs Corp.*, 2002 WL 31741561, *21 (denying Division's request for "massive penalties" and declining to award civil penalties in any amount where the harm to others was not great and Respondents had not enriched themselves financially). As a general rule, the Commission seeks to impose civil penalties that bear some relationship to the amount of disgorgement. *Id.* The ALJ, however, failed to do so here, and likewise failed to provide any explanation for his departure from the Commission's usual practice.

<u>No prior violations or likelihood of future ones</u>. Bebo has never before been found to have (or been accused of having) violated state or federal securities laws, and there was no evidence that she is at risk of violating those laws in the future. The conclusion that she is a risk to violate the securities laws in the future is based on mere conjecture. The law requires more. *See SEC v. Brown*, 878 F.Supp.2d 109, 119 (D.D.C. 2012).

<u>Assurances against future violations.</u> The mere fact that Bebo chose to vigorously contest the allegations raised against her rather than give in to the SEC's demands that she concede to wrongdoing does not make her any more likely to violate securities laws in the future.

Like any respondent, Bebo had the right to defend herself against the Division's specious allegations, and she should not be penalized merely because she has exercised that right. *See SEC v. Johnson*, 595 F.Supp.2d 40, 45 (D.D.C. 2009); *SEC v. Ingoldsby*, 1990 WL 120731, *3 (D. Mass. May 15, 1990).

Deterrence. And finally, the ALJ's conclusion that there is "a need to deter [Bebo] and others from committing accounting fraud" is demonstrably false. (Dec. 80.) This case did not even involve accounting fraud. There is no dispute that ALC's financial statements were accurate and that ALC disclosed the worst case scenario if it defaulted under the Ventas Lease. Moreover, because the allegations of securities fraud are tied so closely to the particular facts of this case, and the interpretation and meaning of the specific contract provisions at issue here, it is highly unlikely that even drastic monetary sanctions like those ordered by the ALJ would have more than a negligible deterrent effect beyond this case.[25]

In sum, the public interest factors weigh against the imposition of maximum (or any) monetary penalties. Although the ALJ failed to seriously consider any of the mitigating factors, beyond merely mentioning and then summarily dismissing some of them, a meaningful analysis of the required factors shows that any significant monetary penalty is not appropriate here.

D. Bebo's Reliance On The Advice Of Counsel Further Mitigates Any Otherwise Appropriate Sanctions.

Like the many other mitigating factors discussed above, the ALJ also ignored the involvement of ALC's general counsel in the underlying treatment of the Ventas financial covenants and the employee-leasing practices, as well as the extent to which Bebo relied upon his advice. This too was error.

[25] Moreover, the ALJ's conclusion that $4.2 million is the amount necessary to deter accounting fraud is patently erroneous given that the Commission approved sanctioning Buono, ALC's Chief Financial Officer, only $100,000 for his involvement in the exact same conduct. *In the Matter of Laurie Bebo and John Buono, CPA*, Exchange Act Release No. 74177 (Jan. 29, 2015).

"Reliance upon advice of counsel is a fact that may be taken into account in determining what sanctions are appropriate. . . ." *In re Coxon*, Release No. 140, 1999 WL 178558, *10 (Apr. 1, 1999); *see also Blinder, Robinson & Co. v. SEC*, 837 F.2d 1099, 1109 (D.C. Cir. 1988); *Howard v. SEC*, 376 F.3d 1136, 1147-48 (D.C. Cir. 2004). The extent to which Bebo relied on the advice of counsel is relevant to the determination of whether sanctions are in the public interest. The record demonstrates that Bebo relied in good faith on the advice of ALC's general counsel with respect to the Ventas lease covenant calculations in general and employee-leasing in particular.

E. The $4.2 million Civil Penalty Should Be Reversed Because Bebo Does Not Have The Ability To Pay It.

Because it could not be anticipated that the ALJ would impermissibly stack violations and penalties in contravention of the language of the statute, precedent interpreting the statute, and other applicable law, Bebo did not make a showing in the post-hearing briefing regarding her ability to pay any civil penalty imposed. The ALJ's imposition of a $4.2 million penalty should be reversed because Bebo does not have the ability to pay it.[26]

THIS ADMINISTRATIVE PROCEEDING IS UNCONSTITUTIONAL AND MUST BE DISMISSED

Instead of defending herself before an impartial judge in a federal court with basic procedural and constitutional safeguards—including the right to a trial by jury and the right to conduct depositions and other discovery under the Federal Rules of Civil Procedure—Bebo has been forced to defend herself against ruinous financial penalties in this administrative proceeding where the SEC is the prosecutor, judge, and initial appeals court. This proceeding is unconstitutional on several accounts.

[26] Bebo files under seal a sworn financial disclosure statement contemporaneously with this brief in accordance with Rules of Practice 410(c) and 630.

X. The Federal Law Enabling This Proceeding, Dodd-Frank Section 929P(a), Is Facially Unconstitutional.

For the first fifty years of the SEC's existence, it had no authority to obtain monetary penalties at all, much less from ordinary citizens who were not regulated members of the securities industry. Rather, the SEC was limited to seeking injunctions in federal court of on-going fraud or disgorgement. *See* Carole B. Silver, *Penalizing Insider Trading: A Critical Assessment Of The Insider Trading Sanctions Act of 1984*, 1985 Duke L.J. 960, 960-63, 966.

Congress expanded the SEC's enforcement authority in 1984 by allowing the SEC to seek civil penalties in federal court in limited insider trading cases, and then in 1990 by allowing the SEC to seek civil penalties against regulated persons in administrative proceedings and against unregulated citizens in federal court. *Id.* (citing Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264); Pub. L. No. 101-429, 104 Stat. 931, §§ 201-02, 301-02 (1990).

Thus, as with all other federal agencies, the level of process afforded to the citizen being charged by the SEC tracked the punitive gradient of the remedy sought; more severe and punitive remedies were allowed in federal court where the defendant is entitled to robust procedural safeguards.[27] This regime set a delicate balance—one that in various decisions from the Supreme Court evaluating similar agency adjudication frameworks was held constitutionally permissible. *See, e.g., Atlas Roofing Co. v. Occupational Safety & Health Review Comm'n*, 430 U.S. 442 (1977).

The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 929P(a), destroyed that balance when it granted the SEC authority to obtain civil penalties against any citizen in an administrative proceeding. Pub. L. No. 111-203, 124 Stat. 1376 (2010). The

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[27] For example, see the different penalty schemes for administrative versus federal court enforcement actions brought by the Environmental Protection Agency, 33 U.S.C. §§ 1319(g), 1319(d), and the Federal Trade Commission, 15 U.S.C. §§ 45(b), 53(b).

remedies the SEC can seek administratively are now functionally identical to the remedies it can obtain in federal district court.[28] The legislative history regarding Section 929P(a) confirms Congress' intent was to "mak[e] the SEC's authority in administrative penalty proceedings coextensive with its authority to seek penalties in Federal court." H.R. Rep. No. 111-687, at 78 (2010).

By granting this parity of remedy, Congress upset the balance that the Supreme Court had approved and in a manner not permitted by the Constitution. The fundamental constitutional deficiency of the new structure is that the government prosecutor—the SEC— has the sole power to provide or withhold a citizen's right to a jury trial. And the SEC will only grant the citizen her constitutional right to a jury trial when it, in consultation with the Division of Enforcement attorneys who conducted the investigation, concludes it is an advantageous litigation tactic to file in district court.[29]

The SEC's decision to bring its enforcement actions in one forum as opposed to the other is not guided by any reasoned direction from Congress, as SEC attorneys have acknowledged. When recently asked by a federal judge to articulate the criteria that the SEC uses to determine whether to charge a person in federal versus administrative court, an SEC attorney responded: "To start with, Congress gave the SEC two distinct paths that it can follow in pursuing a civil action. … *It did not provide any criteria as to when the Commission would or should do one versus the other.* It's entirely left to the Commission's discretion. The Commission decides—

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[28] The SEC's enforcement director acknowledged that the remedies available in either forum are on par. *See Officials discuss administrative proceedings and more at PLI conference*, Fed. Sec. L. Rep. (CCH) No. 2655, at 2 (Nov. 20, 2014).

[29] *See* Andrew Ceresney, Remarks to the American Bar Association's Business Law Section Fall Meeting (Nov. 21, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370543515297#.VJ25mV4AA.

does not have formal criteria." Tr. of Mot. for TRO at 66-67, *Jarkesy v. SEC*, No. 1:14-cv-00114-BAH (D.D.C. June 11, 2014) (ECF No. 22) (emphasis added).

Although the Division of Enforcement has since issued purported "guidelines" for forum forum selection in its enforcement actions (subsequent to the initiation of these proceedings), the proceedings), the non-exhaustive list of four factors described therein does not include any any direction from Congress.[30] And boiled down to their essences, the "guidelines" simply say the Commission decides forum on a case-by-case basis depending on which forum it believes would be most advantageous to the government.

As set forth in more detail below, the legal scheme established by Dodd-Frank is facially unconstitutional under the equal protection and due process guarantees of the Fifth Amendment. A successful "facial attack means the statute is wholly invalid and cannot be applied to anyone." *Ezell v. City of Chi.*, 651 F.3d 684, 698 (7th Cir. 2011). Consequently, this proceeding must be dismissed.

A. Dodd-Frank Section 929P(a) violates Fifth Amendment equal protection.

The Constitution's promise of equal protection ensures that when the government creates a law that treats similarly situated people differently, the law's classification is rationally based. *Romer v. Evans*, 517 U.S. 620, 631 (1996). If the law does not have a legitimate objective, or if the classification rests on grounds irrelevant to the achievement of a legitimate objective, the law must be struck down. *Id.* A statutory scheme that, for no legitimate purpose, affords some

[30] *See* U.S. Securities and Exchange Commission, *Division of Enforcement Approach to Forum Selection in Contested Actions*, https://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf (last visited January 8, 2016).

litigants a jury trial while denying the same to similarly situated litigants violates the Fifth Amendment's equal protection guarantee.[31]

The Supreme Court's consideration in *Baxstrom v. Herold* of such a statutory scheme is instructive. 383 U.S. 107 (1966). The petitioner in *Baxstrom*, a New York prison inmate, challenged the state law that allowed for inmates at the end of their sentences to be committed to a mental hospital without the jury review available to all other persons civilly committed. *Id.* at 110.

Applying rational basis scrutiny, the Court found "no conceivable basis for distinguishing the commitment of a person who is nearing the end of a penal term from all other civil commitments." *Id.* at 111-12. Where the question to be determined by the tribunal (sanity) and the potential outcome (commitment) was the same for both classes, equal protection required that both classes be given the same protections. *Id.* The Court explained that "the State, having made this substantial review proceeding generally available on this issue, may not, consistent with the Equal Protection Clause of the Fourteenth Amendment, arbitrarily withhold it from some." *Id.* at 111.

Almost a decade later the Supreme Court again considered the equal protection implications of a state's commitment laws, this time in Wisconsin. *Humphrey v. Cady*, 405 U.S. 504 (1972). A person committed under Wisconsin's Mental Health Act at that time had a statutory right to have a jury determine whether he met the standards for commitment, but a person facing commitment under Wisconsin's Sex Crimes Act, like the petitioner, did not. *Id.* at 508.

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[31] The Due Process Clause of the Fifth Amendment includes an equal protection guarantee enforceable against the federal government. The Court's approach to Fifth Amendment equal protection claims "has always been precisely the same as to equal protection claims under the Fourteenth Amendment." *Weinberger v. Wiesenfeld*, 420 U.S. 636, 638 n.2 (1975).

Though the Court remanded before finding a constitutional violation, it noted in strong language the constitutional problem with denying a jury to one class of commitment candidates but not another when the determination to be made and the potential outcome was the same for both classes. If it developed on remand that the "petitioner was deprived of a jury determination, or of other procedural protections, merely by the arbitrary decision of the State to seek his commitment under one statute rather than the other," the Court stated, "[t]he equal protection claim would seem to be especially persuasive . . . ." *Id.* at 512.

Applied here, *Baxstrom* and *Humphrey* stand for the proposition that when the alleged wrongful conduct and the remedy sought are the *same*, a law that allows the government arbitrarily to choose its forum (and thereby choose whether the defendant will receive a jury trial) violates the Constitution's promise of equal protection. Such is the case with Dodd-Frank Section 929P(a), which grants the SEC authority to obtain civil penalties against any citizen in either district court, where the defendant can elect to be tried before a jury, or an administrative proceeding, where she cannot. If the "arbitrary decision of the State to seek . . . commitment under one statute rather than the other" was viewed with such judicial ire in *Humphrey*, so must be the SEC's authority arbitrarily to select its forum, one with a jury and one without. *Id.*

This case is not like *Engquist v. Oregon Department of Agriculture*, 553 U.S. 591 (2008), on which the ALJ relied to support his finding that Section 929P(a) does not violate equal protection. Here, Bebo is not challenging the exercise of government discretion, but the existence of the discretion altogether. And the *Engquist* holding was specifically limited to public employment decisions, while recognizing the applicability of equal protection review to legislative and regulatory actions. *Id.* at 596-98. *Engquist* is inapposite.

The ALJ further hypothesized that the government's interest in passing Section 929P(a) was to protect the country's financial system, and its award of forum selection discretion is rationally related to that interest. But the question is not whether Congress had a rational basis in expanding the SEC's enforcement authority; it is whether the government—the SEC—has a rational basis to distinguish between citizens who will be tried in federal court and those who will be tried administratively. In *Humphrey,* the Supreme Court noted the equal protection problem with a prosecutor *having discretion* to seek a remedy for certain conduct under either of two laws, only one of which provided for a jury determination. The Court did not analyze whether the legislature had a rational basis for requiring commitment proceedings or for passing both mental health and sex crimes laws, but rather whether the petitioner was deprived a jury determination "merely by the arbitrary decision of the State to seek his commitment under one statute rather than the other." 405 U.S. at 512.

Here, the government's unequal treatment under Section 929P(a) of unregulated people accused of securities violations is *at best* arbitrary. Even under the least stringent form of constitutional scrutiny, a discriminatory law that has an *illegitimate* purpose must be struck down.

B. Dodd-Frank Section 929P(a) violates Fifth Amendment substantive due process.

Section 929P(a) of Dodd-Frank also violates Bebo's right to substantive due process because it allows SEC prosecutors to punish her for her prospective exercise of a constitutional right (electing to be tried by a jury) by subjecting her to an administrative proceeding instead where she cannot exercise that right. When the principal objective of a statutory scheme or government practice is "to discourage the assertion of constitutional rights[,] it is patently unconstitutional." *Chaffin v. Stynchcombe*, 412 U.S. 17, 33 n.20

(1973) (internal citation omitted). Courts have on many occasions invalidated statutory provisions that penalize citizens for possessing or exercising their constitutional rights.

The Supreme Court's decision in *Blackledge v. Perry*, 417 U.S. 21 (1974) is instructive. There, the Court found unconstitutional the prosecutorial discretion authorized by a law that permitted the prosecutor to obtain a felony indictment after the defendant exercised his right to have a jury determine his original misdemeanor charge for the same conduct. *Id.* at 23. The Court held that the *mere risk* of prosecutors punishing defendants for exercising their right to a jury determination violated due process. *Id.* at 28-29. The Court required no actual evidence of foul motive because the statute itself made it possible for an improper motive to enter the government's decision-making.[32] *Id.*; *see also United States v. Jackson*, 390 U.S. 570 (1968) (striking law that punished exercise of jury trial right); *United States v. Alvarado-Sandoval*, 557 F.2d 645, 645-46 (9th Cir. 1977) (preemptive punishment of the citizen's prospective exercise of a constitutional right no less a constitutional violation).

Dodd-Frank allows the government to penalize a citizen for possessing the right to a jury in federal court by bringing its claims administratively. Moreover, Dodd-Frank also permits the SEC to file a case in district court and then, if the defendant asserts her right to a jury, voluntarily dismiss the case and seek the same remedies administratively. Such a practice runs afoul of the dictates of established precedent. The ALJ below dismissed as "speculative" and "unlikely" the possibility that the SEC would voluntarily dismiss a district court case and re-file administratively if the respondent exercises her right to a jury trial. (Dec. at 73.) But it is the possibility that a prosecutor will punish the exercise of a constitutional right, and the perverse

[32] Notably, the Court recognized the government's interest in streamlining prosecutions and conserving resources as potentially driving the decision to retaliate against persons who exercised their right to have a new *de novo* trial in front of a jury and impermissibly injecting "the opportunities for vindictiveness" into the decisions. *Perry*, 417 U.S. at 27-28. Expediency, of course, is the same factor that creates the opportunity for vindictiveness in the SEC's forum selection.

incentive to do so created by Dodd-Frank, that makes the law unconstitutional. *Perry*, 417 U.S. at 28.

XI. The SEC's Chosen Forum Violates Article II Of The Constitution.

Whether the prescriptions of Article II apply to SEC ALJs depends on their being constitutional "officers." *See* U.S. Const. art. II, § 2, cl. 2; *see also Free Enterprise Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 483 (2010) (citing U.S. Const. art. II, § 3, cl. 1). Though the Commission has held that SEC ALJs are not constitutional officers, and therefore Article II does not apply to them, federal district courts have found otherwise. *See, e.g., Hill v. SEC*, No. 1:15-CV-1801, 2015 WL 4307088, *19 (N.D. Ga. June 8, 2015); *Duka v. SEC*, No. 15 CIV. 357, 2015 WL 4940057, *2 (S.D.N.Y. Aug. 3, 2015).

Assuming they are "inferior officers," SEC ALJs indisputably violate the Appointments Clause because they are not appointed by the President, the head of a department, or the judiciary. *See In the Matter of Raymond J. Lucia Cos. & Raymond J. Lucia, Sr.*, Release No. 4190, 2015 WL 5172953, *21 (Sept. 3, 2015).

They also violate the Take Care Clause because there are multiple layers of good-cause protection between the President and the ALJs. *See* 5 U.S.C. §§ 1202(d), 7521(a); *Free Enterprise*, 561 U.S. at 487, 495 (citations omitted).

This proceeding, overseen by an ALJ without proper constitutional authority, is void and must be dismissed. *See Freytag v. Comm'r.*, 501 U.S. 868, 879 (1991) (constitutional defect in the authority of presiding judge affects validity of proceeding itself).

XII. This Administrative Proceeding Has Deprived Bebo Of Her Right To Procedural Due Process.

In determining whether governmental action has violated procedural due process, courts first consider whether plaintiffs will be deprived of a liberty or property interest,

and then determine "what process is due." *Cooper v. Salazar*, 196 F.3d 809, 813 (7th Cir. 1999).

In this case, it is indisputable that Bebo has a property interest at stake in the administrative proceeding. *See Wisconsin v. Constantineau*, 400 U.S. 433, 437 (1971); *Goldberg v. Kelly*, 397 U.S. 254, 264 (1970).

The question here is what procedural mechanisms are required for the administrative proceeding to satisfy due process. For this question, the Supreme Court has established a three-factor balancing test: (1) assessing the "private interest" at issue; (2) evaluating the risk of an erroneous deprivation of the interest because of the procedures employed; and (3) review of the government's interest and burdens that additional or substitute procedural requirement would entail. *Mathews v. Eldridge*, 424 U.S. 319, 334-35 (1976).

As set forth below, a balancing of these factors demonstrates that Bebo was deprived of procedural due process in this case.

A. The Private Interest Is Significant.

Here the reputational and financial implication of the proceeding was life-altering. The ALJ levied ruinous financial penalties upon Bebo (claiming they were less than the maximum penalty) and permanently barred her from acting as an officer or director of a public company. The significant private interest warrants significant due process protections. *Jenkins v. McKeithen*, 395 U.S. 411, 424 (1969).

B. The Risk Of Erroneous Deprivation Of Bebo's Property Interest Is High.

1. The SEC's choice of forum prevented Bebo from compelling testimony from or cross-examining key witnesses.

Due process generally requires that a citizen subject to an administrative adjudication have the right to present evidence, call witnesses on her behalf, and cross-examine adverse witnesses. *Jenkins*, 395 U.S. at 429; *Washington v. Texas*, 388 U.S. 14, 19 (1967).

The SEC's choice to bring its case administratively instead of in district court meant that Bebo was unable to cross-examine or call key witnesses on her own behalf, even though the Division compelled testimony from them in the investigation. (Exs. 1982, 1984.) Hennigar, the chairman of the Board, and Ng, the chairwoman of the Audit Committee, are Canadian citizens residing outside the Commission's subpoena power; Bebo could not compel their testimony at the hearing. *See* 15 U.S.C. § 78u(b). Bebo was further prejudiced because, prior to the hearing, the ALJ read the transcripts of Ng and Hennigar's investigative testimony (Tr. 106-07), which effectively constituted the Division's direct examination of them.

Their testimony would have informed the issue of scienter, the critical inquiry in most securities fraud cases. Disclosure of the alleged fraudulent conduct to the company's Board (among others inside and outside the company) is obviously inconsistent with intent to deceive investors, and both witnesses could have provided material exculpatory evidence, particularly Ng, as other witnesses testified that she was well-informed about employee-leasing.

2. This proceeding denied Bebo due process in multiple other ways.

Bebo was treated unfairly in these proceedings from the start, and the unfairness persisted throughout the hearing.

First, Bebo was not given adequate time to prepare. The Division issued forty-three subpoenas for testimony or documents, collected millions of pages of documents (approximately 270 gigabytes of data), and took fifty-five days of on-the-record testimony from thirty-three witnesses. Despite the complex legal and factual circumstances of the case, the scope of the factual circumstances (the OIP's allegations span five years), the massive investigative file given to Bebo in a format that presented immense technical difficulties, the number of witnesses, and the need for

multiple expert witnesses, the ALJ denied her extension motions. She was given four months to prepare for a four-week trial.

Second, the ALJ demonstrated bias in favor of the Division from the start, and it infected each stage and day of the proceedings, culminating in his Decision. From refusing to allow Bebo's experts to testify, to allowing the Division to present wholly irrelevant evidence, to reviewing full investigation transcripts of Henniger and Ng prior to the hearing that the Division improperly sought to admit and Bebo opposed, to sustaining practically every objection the Division made and overruling almost all of Bebo's, the ALJ's bias permeated throughout the courtroom. Notably, this is not the first time that a respondent in front of this ALJ has raised legitimate concerns with respect to his impartiality. *See, e.g., In the Matter of Timbervest, LLC*, 2015 WL 3507107 (June 4, 2015) (Commission asked ALJ Elliot to submit an affidavit with respect to whether he felt pressure to rule in favor of the Division). Bebo was entitled to an impartial fact-finder, which did not occur here. *See Megill v. Bd. of Regents of State of Fla.*, 541 F.2d 1073, 1079 (5th Cir. 1976) ("An impartial decisionmaker is a basic constituent of minimum due process.").

Third, Division attorneys intimidated and influenced witnesses (*see, e.g.*, Exs. 1967, 1970; Tr. 1437-40 (Buntain false declration)), which the ALJ precluded Bebo from exploring by quashing Bebo's efforts to obtain testimony from SEC personnel related to these matters. (4/3/2015 ALJ Order; 3/31/2015 Division Motion in Limine.)

Fourth, while denying Bebo access to important witnesses through its forum selection, the Division was permitted to admit declarations from sixteen witnesses without having to subpoena the witnesses or make them available at trial for cross-examination. (2/16/2015 ALJ Order.)

Fifth, the ALJ allowed Ventas representatives to provide speculative testimony about what they "would" have done based on Ventas' typical practices in dealing with lessees (see, e.g., Solari, Tr. 414-17), while prohibiting Bebo from collecting evidence to challenge that testimony. After initially granting Bebo's request for a subpoena to Ventas targeting documents related to how Ventas treated other lessees in similar circumstances (i.e. covenant violations, lease modifications, etc.), the ALJ then quashed the subpoena when Ventas objected, finding that the requested information was not relevant. (*See* Release No. AP-2410.)

Sixth, the Court prohibited Bebo from using the Division's or the witnesses' own language when cross-examining and attempting to impeach witnesses. Through the course of its investigation, the Division used the term "employee leasing" in more than fifty questions just while taking the testimony of Bebo and Buono (*See* Exs. 496-502), and the Division used the term in questions at trial roughly thirty-five times. Yet, when Bebo's counsel attempted to use the language to either question or impeach witnesses, it was often met by objections from the Division and derision from the ALJ.

Finally, by choosing to prosecute her administratively, the government denied Bebo the ability to fully investigate the facts and circumstances surrounding her missing or destroyed hand-written notes and Board materials, which included notes of the Solari Call among other critical communications (*e.g.* deposing the Canadian directors and having additional time and procedures). (*See, e.g.,* Tr. 3857-66, 3209-13, 3272-74.)

C. There Is No Significant Governmental Interest In Depriving Bebo Of Adequate Process.

The final factor of the test courts use to discern the risk of a procedural due process violation is based on an assessment of the fiscal or administrative burdens that an additional or substitute procedural requirement would entail. *Mathews*, 424 U.S. at 335. Here, the Division

could have filed in federal court with minimal additional burden, given that was the only place to adjudicate this type of claim for the first 80 years of the Commission's existence. *See Cooper*, 196 F.3d at 814.

Dated this 28th day of January, 2016.

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CERTIFICATE OF COMPLIANCE

Pursuant to Commission Rule of Practice Rule 450(d), I hereby certify that the Respondents' Opening Brief In Support Of Her Appeal To The Commission complies with the length limitation set forth in Commission Rule of Practice 450(c). According to the Word Count function of Microsoft Word, this brief contains 20,846 words, exclusive of the table of contents, table of authorities, cover page/caption, and this certification.

Dated: January 28, 2016

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