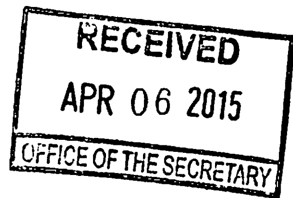
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-16293

In the Matter of **LAURIE BEBO, and** **JOHN BUONO, CPA** **Respondents.**	**RESPONDENT LAURIE BEBO'S PREHEARING BRIEF**

The Division of Enforcement's case is a classic example of losing the forest for the trees, resulting in the misplaced allocation of inordinate government resources focused on a liability theory without adequate factual or legal support. The Division's liability theory is contrived from a theoretical dispute between counterparties to a contract that was never material to the operations of ALC or investors' decisions about whether to buy or sell ALC securities. The Division's case relies upon a series of misunderstandings about required securities disclosures, both legally and upon the specific facts of the Ventas, Inc. lease with Assisted Living Concepts, Inc. ("ALC"). Indeed, at its inception, there was no obligation under the securities laws for ALC to say anything at all to investors about the Ventas lease itself—at best its disclosure was discretionary.

A *potential* dispute about compliance with lease covenants should have been relegated to a matter of resolution between the parties to the contract. Here, in fact, when Ventas sought to amend its complaint filed in litigation against ALC regarding covenant violations entirely unrelated to the subject of this case, it chose to not include the types of alleged covenant violations that form the basis of the Division's liability theory. When ALC ultimately settled its

disputes with Ventas, it purchased the CaraVita properties for a reasonable price—so reasonable that paying the interest on the additional borrowing to buy the properties was cheaper than the rent ALC paid to Ventas. Consequently, the purchase of the buildings actually had the effect of increasing ALC's income and earnings.

In short, the Division's liability theory relies on a nonmaterial violation of a nonmaterial lease that, not surprisingly, resulted in no statistically significant movement in the market for ALC's stock after it publicly disclosed allegations about rentals related to employees contained in a letter from Ventas, further demonstrating its nonmateriality as a matter of law. And the materiality of the alleged violations of this nonmaterial lease hinged largely on Ventas' ability to enforce the payment acceleration clause of the lease—itself an unenforceable penalty for a majority of the buildings covered by the lease.

Moreover, the CaraVita facilities—the eight buildings covered by the Ventas lease—constituted a small part of ALC's business and even a smaller part of Ventas' business. The Ventas lease was rife with ambiguity and undefined terms which now form the basis of the Division's liability theory. Critically, one, and only one, participant to the conversation between the parties to clarify those ambiguous terms recalls the content of that conversation; namely, respondent Laurie Bebo. Because this Court has already ruled the practices and policies of Ventas are not relevant for these proceedings, Ventas' representative's speculation as to what the company "would have done" or "would not have agreed upon" is irrelevant and not supported by a requisite foundation of personal knowledge of the actual agreement between ALC and Ventas. Such speculative testimony should be prohibited consistent with the Court's prior ruling. While the deposition testimony is replete with the Division's attorneys persisting with highly suggestive statements and leading questions, leaving witnesses with contradictory testimony of little

evidentiary value, those efforts were, and continue to be, futile in manufacturing a liability theory here.

But the understanding with Ventas did not just take place during a phone conversation. In addition, ALC provided written "confirmation" of its "notification" of ALC room rentals "related to employees" following the conversation. Ms. Bebo was aware that this written notification was circulated to at least three Ventas executives responsible for managing the CaraVita Facilities, and no one ever raised an objection to the written disclosure of this practice. Admittedly, the written confirmation of that agreement was not as detailed as it could have been, but if permitted to testify on this subject, Ventas personnel will state, incredibly, that in their view there was no agreement *of any sort*, notwithstanding the written confirmation to the contrary.

As for the Division's allegations related to scienter, Ms. Bebo's openness and transparency at ALC with respect to the use of corporate room allocation for employees is highly inconsistent with someone attempting to commit a fraud. She consulted with ALC's general counsel, who was undisputably aware of the material facts about ALC's method of lease compliance and vetted ALC's disclosure with respect to ALC's compliance with the Ventas lease in ALC's filings with the Commission. Numerous executives among ALC's financial reporting and accounting staff were involved in the lease compliance process, a process that was developed by ALC's Chief Financial Officer, Mr. Buono. ALC's Board of Directors, including its Audit Committee, was aware of the practice and instructed Ms. Bebo to proceed with the employee leasing arrangements.[1] Finally, ALC's outside auditor, Grant Thornton, was aware of the material facts related to the employee leasing (including the written confirmation of

---

[1] Designating rooms for employees who travel or had reason to travel to CaraVita facilities is referred throughout this brief and will be through testimony by various designations, including but not limited to the "employee leasing program" and the "employee rooms set aside program."

employee leasing that ALC provided to Ventas) and did not raise objections about it. This clearly demonstrates Ms. Bebo had no intent to defraud ALC's investors and further demonstrates that Ms. Bebo reasonably believed that utilizing corporate rooms allocated for employee use was appropriate and consistent with the oral agreement she reached with Ventas and the subsequent written confirmation of the same.

Ms. Bebo will concede that in hindsight the processes and procedures for maintaining internal lists of employees used to confirm that ALC had enough employees traveling or with a reason to travel to the CaraVita Facilities to support the corporate allocations were not as robust as they should have been. Checks and balances between her and the financial office within ALC failed to catch mistakes of employees or family members that should not have been on the list. Conversely, employees eligible to have been placed on the list during the same period were not so designated.

Ms. Bebo is fully prepared to explain the basis for her reasonable belief that statements regarding covenant compliance were correct, but Ms. Bebo is not the only person to reach that conclusion. ALC's Board reached the same conclusion—months after Ms. Bebo ceased her employment as CEO—after spending millions of dollars on an internal investigation conducted by a prominent New York law firm, Milbank Tweed Hadley & McCloy ("Milbank"). Milbank disclosed the results of its investigation to Grant Thornton, so that Grant Thornton could determine whether any of ALC's prior financial statements or filings with the Commission needed to be restated or amended. The Milbank investigation revealed no basis upon which to restate the financial statements or disclosures regarding compliance with the lease covenants that were filed with the Commission while Ms. Bebo was CEO.

In addition, months prior to Milbank even starting its investigation, ALC's Board requested that ALC's outside counsel provide an opinion about the reasonableness of employee leasing to meet covenants. Outside counsel concluded that the practice was defensible, and a senior partner at that law firm will so testify at the hearing, as will Ms. Bebo's expert with respect to leasing in the assisted living industry.

Rather than repeat further the arguments previously shared with the Division, Ms. Bebo respectfully submits, and attaches hereto, her Wells submission of August 1, 2014, as well as a supplement to the same, dated September 26, 2014. Ms. Bebo's Wells materials set forth the basic legal framework that should be applied to the claims alleged by the Division in this matter, and summarizes the basic evidence that will be presented at the hearing in this matter as it existed at the time based on the Division's one-sided and skewed investigation of the case. Ms. Bebo will obviously present additional favorable testimony not presented in her Wells submission from those witnesses identified, as well as testimony from entirely new witnesses. She will also present documentary evidence that was unavailable to her during the Wells process. Indeed, every day Ms. Bebo is uncovering new, material exculpatory evidence from the investigative file and recent document productions. And she is still seeking additional evidence material to her defense from subpoenaed entities and individuals, including the Milbank law firm. Consequently, given the evolving nature of the evidence and the compressed (and unconstitutional) nature of the proceedings, Ms. Bebo will instead apply her resources to preparing for the hearing itself, and rely on her Wells materials to further adequately frame the issues for the Court.

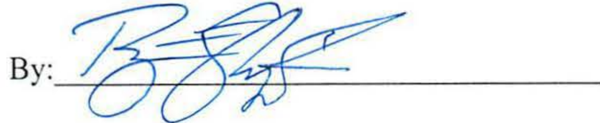
Finally, Ms. Bebo's Wells materials were prepared without the benefit of any expert analysis or testimony. This expert testimony further supports the Division's inability to prove

any material misstatements or prove scienter, as described above. This and additional evidence presented at trial and the legal briefing to follow will amplify and provide greater support to the facts and argument contained in this submission and the attached Wells materials.

In conclusion, Ms. Bebo will respectfully request that this Court find in her favor with respect to the allegations of the Order Instituting Proceedings and dismiss the same with prejudice.

Dated this 3rd day of April, 2015.

REINHART BOERNER VAN DEUREN S.C.
Counsel for Respondent Laurie Bebo

By: 

Mark A. Cameli
WI State Bar No.: 1012040
E-mail: mcameli@reinhartlaw.com
Ryan S. Stippich
IL State Bar No.: 6276002
E-mail: rstippich@reinhartlaw.com

1000 North Water Street, Suite 1700
Milwaukee, WI 53202
Telephone: 414-298-1000
Facsimile: 414-298-8097

Mixed Sources
www.fsc.org Cert no SW-COC-002980
© 1996 Forest Stewardship Council

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LAURIE A. BEBO PURSUANT TO 17 CFR § 200.83

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the matter of:

Assisted Living Concepts, Inc. No. C-7948

**WELLS SUBMISSION ON BEHALF OF
LAURIE A. BEBO**

Mark A. Cameli
mcameli@reinhartlaw.com
Ryan S. Stippich
rstippich@reinhartlaw.com
Reinhart Boerner Van Deuren s.c.
1000 North Water Street, Suite 1700
Milwaukee, WI 53202
Telephone: 414-298-1000
Facsimile: 414-298-8097

TABLE OF CONTENTS

Page

INTRODUCTION AND EXECUTIVE SUMMARY 1

FACTUAL BACKGROUND 3

I. Background of ALC, Ventas and the CaraVita Facilities 3

A. The CaraVita Facilities constituted a small part of ALC's business 3

B. The CaraVita Facilities constituted an even smaller part of Ventas' Business 4

II. ALC's Acquisition of the CaraVita Operations 4

III. Key Lease Provisions 5

A. Among other terms, neither "occupancy" nor "occupant" is defined in the Lease 5

B. Affiliated transactions provision requires "disclosure" not "notice." 6

C. Employees staying at the CaraVita Facilities to serve the operations of the buildings do not violate the Primary Intended Use provision of the Lease 7

D. ALC could remove up to 10% of the operational beds from service 7

E. There was no waiver, amendment or modification to the Lease 7

IV. ALC's Experience With The CaraVita Facilities After Taking Over Operations From Old CaraVita 8

V. At the Meeting With Ms. Cafaro, She Told Ms. Bebo That Joe Solari Should Be Her Point of Contact to Discuss Important Matters Related to the CaraVita Facilities 8

VI. Ventas Agrees to Permit ALC to Pay for Rooms for Employees Who Stayed or Had Reason to Stay at the CaraVita Facilities 9

A. ALC learns that Old CaraVita had employees living at the CaraVita Facilities 9

B. Mr. Solari agrees to the employee leasing arrangement during a January 20, 2009 telephone call 10

C. Ms. Bebo's notes of this key discussion are missing, along with a host of other materials 12

D. Ms. Bebo sends a confirmatory e-mail to Mr. Solari regarding employee leasing and Ventas makes no objection to the arrangement 13

VII. ALC's Implementation of the Employee Leasing Arrangement 14

A. ALC Board members direct Ms. Bebo to utilize the employee leasing arrangements 14

B. ALC accounting staff sets up procedures for employee leasing arrangement..................15

VIII. Subsequent Communications With Ventas..................16

A. Discussions regarding potential purchase of New Mexico properties..................17

B. Communications regarding CaraVita Facilities..................18

IX. Personnel Involved in ALC's Disclosure Process Considered the Lease Disclosure in Light of the Employee Leasing Arrangement, and No One Suggested a Different Disclosure. 19

X. In Addition to Legal Counsel and Other Members of the Disclosure Committee, ALC's Auditors and Board Knew About and Approved the Use of Employee Leasing to Meet Lease Covenants. 21

DISCUSSION..................22

PART I: THERE IS NO BASIS FOR FRAUD CHARGES AGAINST MS. BEBO 23

I. Elements of a Securities Fraud Cause of Action. 23

II. ALC'S SEC Filings Contained No Actionable Misstatement Regarding Compliance With the Lease Covenants. 23

A. The Standard for Pleading and Proving Falsity of ALC's Opinion That It Was In Legal Compliance With the Lease Covenants. 23

B. ALC's Opinion of Compliance With the Lease Was Objectively Correct..................24

III. ALC's Statements Of Opinion Concerning Compliance With The Lease Are Not Actionable As A Matter Of Law Because There Was No Duty To Disclose Immaterial Information Forming The Basis Of The Opinion Or Predictions About Behavior Of Its Contractual Counter-Party. 25

A. There was no duty to disclose facts related to employee leasing as the basis for ALC's opinion that it complied with the Lease covenants. 27

B. There was no duty to disclose even if the SEC could establish that employee leasing was not in compliance with the Lease. 28

C. Investors did not care about Lease compliance, demonstrating the lack of materiality. ...30

IV. There Is No Evidence That Ms. Bebo Acted With The Requisite Level Of Scienter To Support A Section 10(b) Claim..................31

A. Ms. Bebo's actions taken in implementing employee leasing were not consistent with any intent to deceive, manipulate or defraud. 31

1. Ms. Bebo consulted with counsel. 32

2. Ms. Bebo was aware the disclosure committee never urged different disclosures..................32

3. Ms. Bebo discussed ALC's plan with Ventas. 32

4. Ms. Bebo sent a confirming e-mail to Ventas (which was reviewed by counsel) and Ventas did not object..33

5. Ms. Bebo consulted with ALC's board before implementing...............................33

6. Ms. Bebo understood that the finance department vetted the practice with ALC's auditor. 34

7. Ms. Bebo relied on the finance department for the process and accounting determinations. 34

8. The reasonableness of MS. Bebo's reliance on the propriety of the employee leasing practice is corroborated by the board's inaction upon learning of the Milbank findings. 34

B. ALC had viable alternatives to address covenant compliance if Ms. Bebo had not believed that employee leasing complied with the Lease. 35

C. Ms. Bebo's subsequent communications with Ventas were consistent with her belief in an agreement with Ventas on employee leasing. 36

D. Other evidence does not show that Ms. Bebo acted with an intent to defraud investors. 37

1. Lower-level finance department employees. 37

2. Mr. Buono and Mr. Solari. 38

E. Ms. Bebo had no personal financial interest in committing fraud. 39

PART II: THERE IS NO BASIS FOR NON-FRAUD OR AIDING/ABETTING CLAIMS AGAINST MS. BEBO 40

I. There Is No Basis for a Claim Against Ms. Bebo Under Section 13(a) of the Exchange Act. 40

II. There Is No Basis for a Books and Records or Internal Controls Claim Against Ms. Bebo. 41

A. The Lists Do Not Constitute A Book Or Record Under Section 13(b)(2)(A) And Were Not False. 41

B. There Is No Support for a Claim of Failure to Implement or Conduct Circumventing "Internal Accounting Controls." 42

C. The Commission Cannot Establish the Requisite Mental State..42

III. There Is No Basis for a Rule 13b2-2 Claim for Misleading the Company's Auditors. 42

PART III: PRACTICAL AND POLICY CONSIDERATIONS MILITATE AGAINST A FRAUD ACTION....43

CONCLUSION....45

INTRODUCTION AND EXECUTIVE SUMMARY

By letter dated June 12, 2014, the Chicago Regional Office of the Division of Enforcement Staff (the "Staff") of the United States Securities and Exchange Commission (the "Commission" or "SEC") has informed counsel for Laurie A. Bebo that it intends to recommend that the Commission bring a civil enforcement action against her for various alleged violations of the federal securities laws, which may involve a civil injunctive proceeding, a public administrative proceeding, and/or a cease-and-desist proceeding.

The Staff alleges that Ms. Bebo violated Sections 10(b), 13(a), and 13(b)(5) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rules 10b-5, 13a-14, 13b2-1, and 13b2-2 promulgated thereunder. The Staff also alleges that Ms. Bebo aided and abetted and caused violations by Assisted Living Concepts, Inc. ("ALC" or the "Company") of Section 10(b), 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, and 13a-13 promulgated thereunder. For the reasons explained in this Wells Submission, there is no basis for any such charges.

The allegations principally rely on the assertion that about three lines in the Company's Form 10-Q's and 10-K's for the periods from approximately late 2009 through 2011 were false or misleading. These three lines - out of hundreds of pages of disclosures and financial statement information - stated ALC's opinion or belief that it was in compliance with "certain operating and occupancy covenants" contained in one operating lease the Company had entered into with an affiliate of Ventas, Inc. ("Ventas"). The lease applied to only eight of the approximately 211 assisted living facilities that ALC owned and/or operated.

The Staff argues that this statement was false or misleading because ALC failed to further disclose *how* it was meeting the covenants. ALC did not disclose that management, including Ms. Bebo, believed that they had reached an understanding with Ventas whereby ALC could count toward the occupancy and coverage ratio covenants ALC employees (and others performing services for ALC) who stayed or had reason to stay at the leased facilities.

The Staff's theory that ALC and Ms. Bebo made the statement that the Company was in compliance with the Ventas lease with the intent to mislead investors fails for a number of different reasons. *First*, there was no false statement made in ALC's SEC filings with respect to its compliance with the Ventas lease because (a) the record shows that Ms. Bebo did reach an understanding related to the inclusion of employees towards the lease covenants, and (b) there is no basis to conclude that Ms. Bebo did not subjectively believe that ALC was in compliance through the legitimate counting of employees toward the Lease covenants. Consequently, the statement was true both objectively and subjectively and is therefore inactionable. *Second*, the information with respect to how ALC was meeting the lease covenants was immaterial under the case law and there was no legal duty to disclose that additional information. *Third*, the statement was immaterial as demonstrated by the lack of investor reaction to ALC's disclosure of lawsuit filed by Ventas alleging ALC breached other lease covenants because two state regulators took action with respect to certain facilities' licenses. This is confirmed both by contemporaneous statements by analysts covering ALC's stock and by the fact that there was no statistically significant decline in the Company's share price in the days following its disclosure that Ventas had sued ALC for breaching the lease. *Fourth*, there is no basis to conclude that Ms. Bebo acted with the requisite mental state to support a securities fraud claim. Rather, the evidence supports the conclusion that Ms. Bebo had no fraudulent intent to mislead investors with respect to this aspect of the business. Various factors that support this conclusion include:

- Ms. Bebo had no personal financial incentive to mislead investors about covenant compliance. Her compensation was not affected by the inclusion of employees in the calculations and would not have been effected by a default under the Ventas lease. In addition, she sold no stock during the relevant time period.

- Ms. Bebo sought the input and advice of in-house counsel, Eric Fonstad, at the very beginning of the process. Despite Mr. Fonstad's failed recollection and contradictory testimony, there is indisputable documentary evidence and testimony of other witnesses of his involvement in approving the practice and ALC's public disclosures.

- Ms. Bebo was aware that the Company's Chief Financial Officer was intimately involved in the process, and key members of the finance department, including the Company's assistant controller, internal auditor, and director of financial reporting were aware of and involved in the practice and preparing the Company's disclosures.

- Ms. Bebo was aware that the Company's external auditor, Grant Thornton LLP ("GT"), reviewed the process in its quarterly reviews and annual audits, and never objected to its propriety or suggested different disclosures.

- Ms. Bebo was aware that the Company's board of directors was knowledgeable with respect to how ALC was meeting the lease covenants and specifically approved of the practice.

- Ms. Bebo (and Mr. Buono) were the ones urging prompt disclosure to investors in 2012 when Ventas did allege in correspondence and a lawsuit that ALC had breached the Lease (for the licensing issues) - against great resistance from the board. And when the board refused to disclose, Ms. Bebo submitted a whistleblower claim to the Commission.

* * * * *

In the end, the Staff's recommendation is based on improper second-guessing, with full use and benefit of hindsight, of ALC's opinion that it was in compliance with the Lease covenants - an opinion indisputably shared by legal counsel, other members of the disclosure committee, and the Company's auditors, among others. Staff's position is also inconsistent with the conclusions of the internal investigation conducted by the Company's audit committee, with the assistance of a major New York law firm, which conclusions support the reasonableness of Ms. Bebo's belief that the practice was appropriate.[1]

Staff's pursuit of a claim here has significant implications for companies. Premising liability on a company's genuinely expressed beliefs about its legal compliance would inevitably chill such disclosures. Under the Staff's approach taken in this matter, voluntary disclosures about a company's legal and regulatory environment would become "rite[s] of confession" in which companies would not be able to express their belief that they are in legal compliance without disclosing the many ways in which they *might* not be. *See City of Pontiac Policeman's & Firemen's Ret. Sys. v. UBS AG*, __ F.3d __, 2014 WL 1778041 at *5 (2d Cir. May 6, 2014). The more likely alternative to such public self-

[1] *See* ALC Form 10-Q for the period ending September 30, 2012 at p. 19, which stated: "The previously disclosed internal investigation being conducted by the Board of Directors has been completed. The Board has determined not to take any action."

evaluation is that companies would simply say less, or nothing, about the legal and regulatory environment and accompanying risks.

Pursuing a securities fraud case under these circumstances would also discourage settlement of legal and contractual claims. Whenever a company has previously expressed an opinion about legal compliance in its securities filings, a company would naturally have to weigh the value of settlement with a counter-party against the real risk that the settlement could prompt a claim months or years later for securities fraud liability based on its previous statements of compliance.

In light of the lack of merit to the potential charges, and the implications of the action contemplated, Ms. Bebo requests the Commission decline initiating any action against her.

FACTUAL BACKGROUND

I. Background of ALC, Ventas and the CaraVita Facilities.

Effective January 1, 2008, various subsidiaries[2] 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 (referred to herein as the "CaraVita Facilities").

A. The CaraVita Facilities constituted a small part of ALC's business.

At the time ALC entered into the Lease, it owned or operated approximately 216 assisted and independent living residences in 20 states in the United States.[3] ALC operated about the same number of facilities throughout the relevant time period, with 211 facilities as of the end of 2011.[4] ALC owned the majority of the facilities it operated - 161 of the 211 as of the end of 2011. But it also leased a substantial number as well, 50 facilities as of the end of 2011.[5]

In terms of units, ALC operated over 9,300 units throughout 2009 to 2011. Consequently, the eight CaraVita Facilities constituted only 3.8% of ALC's facilities, 16% of ALC's leased facilities, and 5.8% of the number of its units as of the end of 2011.

ALC generated over $230 million in revenue per year throughout the relevant time period, and generated income from operations ranging from a low of $31.7 million (excluding a one-time goodwill impairment) in 2009 to a high of $43.6 million in 2011.

The CaraVita Facilities constituted a small slice of that revenue and income. In 2011, ALC reported to Ventas that the eight CaraVita Facilities generated $15.7 million.[6] Excluding the approximately $2 million in intercompany revenue that was booked into these facilities for 2011,[7] the

[2] Those subsidiaries are referred to as "Tenants" in the Lease and this Wells submission. References to ALC with respect to the Lease in this submission includes the Tenants unless the context indicates another meaning.

[3] *See* ALC Form 10-Q for the quarter ended March 31, 2008 at p. 6.

[4] *See, e.g.*, ALC Form 10-K for the year ended December 31, 2011 at 14.

[5] *Id.*

[6] February 14, 2012 e-mail from John Buono to Bob Fiorentino with Lease Compliance information for Q4 2011.

[7] 3/19/2012 e-mail from Laurie Bebo to Mel Rhinelander with summary of intercompany account for buyers. ALC00245165-66.

resulting $13.7 million in revenue comprised approximately 5.8% of ALC's overall revenues of $234.5 million in 2011. In the same year, ALC reported to Ventas net operating income of $8.2 million from the CaraVita Facilities in 2011, but this does not include $5.3 million in lease payments.[8] Thus, the CaraVita Facilities' operating income was really $2.9 million, which constituted 6.6% of ALC's operating income in 2011. Backing out the employee-related revenue, operating income was $0.9 million or only 2.1% of ALC's total operating income for 2011.

B. The CaraVita Facilities constituted an even smaller part of Ventas' Business.

In 2008, at the time the Lease was executed, Ventas owned a portfolio of 513 senior housing and healthcare properties. These included 440 "senior housing communities" and skilled nursing facilities.[9] A number of these properties were in the same markets as ALC facilities, so that Ventas was a direct competitor to ALC in a number of markets. As Ventas grew between 2008 and 2012, the number of markets where it competed with ALC also grew.

Ventas had critical business relationships with three entities: Sunrise Senior Living, Inc.; Brookdale Senior Living, Inc.; and Kindred Healthcare, Inc. Sunrise and Brookdale were two of ALC's largest direct competitors in the assisted living industry at the time. Sunrise managed the operations of 79 of Ventas' senior housing communities. Ventas leased 203 of its properties to Kindred (largely skilled nursing facilities) and 83 of its properties to Brookdale.[10] According to Joe Solari, the 8 facilities ALC leased from Ventas was the smallest group of facilities of any operator to which Ventas leased.

Combined, according to Ventas' annual report, properties managed or leased by these three companies represented 83.7% of Ventas' revenue, and 79.1% of Ventas' net operating income for 2008.

By contrast, the revenue derived from the rent paid by ALC was insignificant. For example, the fixed rent paid by ALC to Ventas in 2008 was approximately $4.9 million. The same year Ventas reported overall revenue of $929.7 million.[11] Thus, the rent from ALC constituted only 0.5% of Ventas overall revenue and only 1% of its rental revenue from its triple-net lease segment.[12]

II. ALC's Acquisition of the CaraVita Operations.

In 2005, the CaraVita Facilities were owned and operated by two individuals, Josh Coughlin and Laura Elizabeth "Beth" Cayce, through eight special purpose entities, one for each of the eight facilities (referred to herein generally as "Old CaraVita"). Old CaraVita was a small "mom-and-pop" operation. Thus, the operation of the buildings to support the rent payments was important as there was no significant financial backing to a guaranty behind the facilities.

Probably due to the small portfolio of eight buildings, Ventas and Old CaraVita signed a lease that appears to have been modeled on one of Ventas' standard skilled nursing facility leases. It contains

---

[8] *Id.*

[9] Ventas Form 10-K for the year ended December 31, 2008 at p. 79.

[10] *Id.*

[11] *Id.* at 76.

[12] ALC's rent was even more insignificant by 2011 because Ventas had grown significantly through acquisitions and mergers. By the end of 2011, Ventas had 1,378 properties, and reported $1.765 billion in revenue, including $652 million in rent revenue from its triple-net leased assisted living and skilled nursing facilities. Ventas Form 10-K filed for the period ending December 31, 2011 at pp. 1, 97.

a host of provisions that have no applicability whatsoever to assisted and independent living facilities, and also contains a host of provisions relating to Medicare and Medicaid reimbursement, when none of the CaraVita Facilities were ever contracted to participate in Medicare or Medicaid. They were all private pay.

In mid-2007, ALC began exploring a transaction where it would purchase the operations of Old CaraVita. From the beginning, there was a general understanding that ALC would have to step into the shoes of Old CaraVita in its lease with Ventas. There were no changes to many of the provisions of the Old CaraVita lease, including the occupancy covenants and financial coverage ratio covenants. ALC made no proposal to Ventas that would materially alter the occupancy and financial coverage ratio covenants. The parties made no attempt to clean up the host of irrelevant provisions that related to skilled nursing facilities and participation in government programs.

When Ms. Bebo asked Mr. Coughlin about the relationship with Ventas, he indicated that Old CaraVita had a good working relationship with Ventas, that Ventas had been flexible and easy to work with, and that he generally had a positive experience.

III. Key Lease Provisions.

Premising a claim for securities fraud based on statements that ALC was in compliance with the terms and covenants of the Lease is complicated by its ambiguous terms, its length, its inclusion of irrelevant and inapplicable provisions, and a host of subjective determinations that resulted in the stated opinion that ALC was in compliance. Set forth below is our view of some of the key provisions of the Lease and how ALC interpreted them. Importantly, Ms. Bebo would not have to establish that this is the correct interpretation of the Lease. In a fraud action, the SEC would have to establish that ALC's interpretation was so unreasonable that the SEC can meet its burden of proving falsity, materiality, and scienter.

A. Among other terms, neither "occupancy" nor "occupant" is defined in the Lease.

Section 8.2.5(d) of the Lease contains the minimum average occupancy covenant. It states:

> As of the end of each fiscal quarter, the minimum average occupancy rate (i) for the quarter then ended for each Facility shall be greater than or equal to 65%, (ii) for the trailing 12 months then ended (1) for each Facility shall be greater than or equal to 75% and (2) for all Facilities in aggregate shall be greater than or equal to 82%.

Notably, despite 17 pages of definitions for key terms in the Lease (located at Exhibit B to the Lease), neither "occupancy" nor "occupant" are defined in the lease. The Lease could have defined the term with reference to, for example, units occupied by patients or residents or the ratio of patients or residents paying rent to the number of units or beds. The Lease does make similar references along these lines in one of the provisions of the Lease that has no applicability to the CaraVita Facilities. Section 8.2.3(d) requires operator and actuarial reports that are submitted for Medicare or Medicaid purposes, including "any and all of the census information concerning the number of licensed beds occupied by residents or patients..."[13]

[13] The inclusion of language in one section of the contract while excluding it in Section 8.2.5(d) means that "occupancy" in Section 8.2.5(d) must be interpreted as being broader under the doctrine of *expressio unius est exclusio alterius*, which means "expressing one item of [an] associated group or series excludes another left unmentioned.". *See Chevron USA, Inc. v.*

But in Section 8.2.5(d) there is no limiting definition of occupancy or occupant, and even Ventas recognized - in a context unrelated to the employee leasing arrangement - that the tenant had discretion in calculating the occupancy percentage. Soon after ALC took over the Lease from Old CaraVita, Ventas recognized that ALC's calculation of the occupancy rate was far different than Old CaraVita's prior practice. Old CaraVita had calculated the occupancy rate based on the ratio of people/occupied beds to units. Ventas even recognized that, despite declining occupancy, ALC was calculating occupancy based on the ratio of occupied units to operational units, even if there were multiple people staying in a unit. This method of calculating the occupancy rate was less favorable to ALC than Old CaraVita's method.

In a May 6, 2008 e-mail, Ventas personnel noted that ALC's reporting of occupancy based on "units occupied/available" resulted in a calculation about 6% lower than Ventas' calculations based on how Old CaraVita had prepared the calculations.[14] Later in a September 4, 2008 e-mail from William Johnson, a Ventas Asset Manager, to Tim Doman, the Senior Vice President for Asset Management, Mr. Johnson analyzed ALC's occupancy trend for the first six months of 2008, stating, "YOY [Year-Over-Year] is horrible but it's partly due because Josh was using beds[;] we now have ALC using units."[15] Other documents were prepared around the same time (September 5, 2008) which appear to indicate that the calculation differences between the Old CaraVita method and ALC's method could cause an occupancy difference of as much as 20%.

There was similar ambiguity, flexibility, and discretion regarding compliance with the Lease, including calculating the financial coverage ratios. For example, among other things, there was ambiguity, flexibility, and discretion involved in how expenses got allocated among particular facilities or to divisional/regional/corporate levels.

B. Affiliated transactions provision requires "disclosure" not "notice."

Section 8.1.3 of the Lease prohibits any of the Tenants from entering into any transaction with any shareholder or affiliate of the Tenant, "except in the ordinary course of business and on terms that are fully disclosed to Landlord in advance and are no less favorable to any Tenant than would be obtained in a comparable arm's-length transaction with an unrelated third party."

Among other things, Staff has raised issues with ALC discussing the employee leasing arrangements with Joe Solari rather than providing written notice to the persons identified in Section 33 of the Lease.

However, Section 8.1.3 of the Lease does not require "notice" under the Lease. In fact, it does not even specify that disclosure to Ventas be in writing. Given the lack of any requirement of notice or even written communication for the disclosure required by Section 8.1.3 a court would interpret the provision as not requiring formal notice under the Lease. Indeed, by putting the disclosure in writing, ALC went beyond the requirements of Section 8.1.3 for disclosure of affiliated transactions.

Echazabal, 536 U.S. 73, 80 (2002) (internal quotations omitted); *see also Chi. Bd. Of Options Exchange v. Conn. Gen. Life Ins. Co.*, 713 F.2d 254, 258 (7th Cir. 1983).

[14] VSEC0010313.

[15] VSEC0011429.

C. Employees staying at the CaraVita Facilities to serve the operations of the buildings do not violate the Primary Intended Use provision of the Lease.

Section 7.2.1 of the Lease requires that each CaraVita Facility be used "solely for its Primary Intended Use (and shall not change, or consent to or acquiesce in the change of, such Primary Intended Use)." Schedule 1.3 of the lease designates each Facility for use as an independent living, assisted living, or Alzheimer's care facility. Notably, there was flexibility imbedded in the Lease with respect to the Facilities' Primary Intended Use, given that the designations for seven of the eight facilities included Alzheimer's care, but those facilities never held licenses or certificates to provide Alzheimer's care. Moreover, any facility licensed to provide assisted living could also house independent living residents, without any age restriction.

There is no dispute that ALC ever changed the use of any of the Facilities from its "primary" use as an independent or assisted living facility and nothing related to the employee leasing arrangements resulted in ALC losing any required licenses or authorizations necessary to run those Facilities as required for their primary intended uses.

Section 7.2.1 also addresses the operations of the CaraVita Facilities more broadly. It states that ALC "shall operate each Facility in a manner consistent with its current operation as a quality healthcare facility..." Sending employees to stay at the CaraVita Facilities in order to improve the operations of them, whether it be for sales, facility improvement, care improvement, evaluation of operations through mystery shopping, or evaluation of staffing needs, was consistent with the Facility operating as a "quality healthcare facility" and its primary intended use as an assisted or independent living facility. Indeed, ALC had employees routinely stay at all of its facilities - which is also a common industry practice.

D. ALC could remove up to 10% of the operational beds from service.

Section 8.1.11(c) of the Lease allowed ALC, in its unilateral discretion, to remove beds from service at a CaraVita Facility "so long as the number of beds in service at such Facility is not less than 90% of the number of operational beds" set forth on a schedule to the Lease. In other words, ALC had the discretion to remove approximately 54 units or 60 operational beds from service. Removing beds from service would have effectively allowed ALC to remove unoccupied beds from service, reducing the denominator in calculating the minimum average occupancy rate and therefore immediately increasing the occupancy rate.

E. There was no waiver, amendment or modification to the Lease.

The Lease may only be modified "by a writing signed by both Landlord and Tenant."[16] Any waiver by Ventas, including waivers of covenants or other compliance with the Lease need not be in writing or signed by Ventas, and could be effective by conduct, or oral communication as well.[17]

---

[16] Lease, § 42.6.

[17] Lease, § 27 ("No failure by Landlord or Tenant to insist upon the strict performance of any term hereof or to exercise any right, power or remedy consequent upon a breach thereof... shall constitute a waiver of any such breach or of any such term.") and § 42.12 ("All waivers, consents and releases provided for in this Lease are effective only to the extent permitted by applicable law. No waiver of any condition or covenant herein contained, or of any breach of any such condition or covenant, shall be held or taken to be a waiver of any subsequent breach of such covenant or condition, or to permit or excuse its continuance or any future breach thereof, or of Landlord's right to terminate this Lease or exercise any other remedy granted herein on account of such existing breach.").

ALC's conversation with Joe Solari (which, by its terms, was all the Lease required) and subsequent summary e-mail did not effect a modification or waiver under the Lease. Those communications simply confirmed a mutual understanding of ambiguous Lease terms with respect to occupancy under the Lease and how ALC should calculate the occupancy and financial coverage ratios in light of the employee leasing arrangement.

IV. ALC's Experience With The CaraVita Facilities After Taking Over Operations From Old CaraVita.

Upon taking over the operations of the CaraVita Facilities, the financial performance of the facilities declined for a number of different reasons.

First, the macro-economic environment significantly worsened throughout 2008, culminating with the worst recession in decades and the worst financial crisis since the Great Depression in the Fall of 2008. The assisted living business was greatly affected by the recession, and ALC was no different.[18]

Ventas' business, given it operated directly in the real estate market that was deteriorating precipitously, was equally affected, if not more so. Stock prices for many REITs were "imploding" and Ventas' experience was no different.[19] Consequently, in its 2008 10-K filed on February 27, 2009, Ventas told investors and the SEC that due to the financial crisis and turmoil in the capital markets, that the "primary focus" of its business strategy would be "maintaining a strong balance sheet and liquidity...."[20]

In addition, ALC learned that Old CaraVita used an affiliated home healthcare operation in connection with the operation of the CaraVita Facilities. This understated the expenses of the CaraVita Facilities, and overstated the profitability - and presumably the coverage ratios reported to Ventas.

The factors described above, along with ALC's own operational issues with running the CaraVita Facilities, resulted in questions at the August 5, 2008 meeting of the ALC Audit Committee about the implications of non-compliance with the Lease covenants.[21] Mr. Buono prepared a memorandum outlining the decline in occupancy since the acquisition of the portfolio and the trends at the CaraVita Facilities. In particular, Mr. Buono noted the adverse trends at Peachtree Estates and Greenwood Gardens and the potential for breaching the occupancy and/or coverage ratio covenants in the coming quarters if conditions and operations of these Facilities did not improve, or other options were not pursued.

V. At the Meeting With Ms. Cafaro, She Told Ms. Bebo That Joe Solari Should Be Her Point of Contact to Discuss Important Matters Related to the CaraVita Facilities.

Then, in November 2008, Ms. Bebo and Mr. Buono set up a meeting with the CEO of Ventas, Debra Cafaro, to begin a conversation that could result in a negotiation with respect to relief from the covenants or other ways in which ALC and Ventas could work together through the difficult economic

[18] For example, presentation materials Ms. Bebo received from a conference in January 2009 contains statistical data reflecting downward trending occupancy across independent living, assisted living, and nursing care throughout 2007 and 2008. *See* ALC00078401.

[19] Ms. Bebo and Mr. Buono had received a November 11, 2008 report from an equity analyst titled "REITs Getting Pounded" which included Ventas on a list of large-cap REITs whose stock prices were down more than 30% year-to-date.

[20] Ventas Form 10-K for the year ended December 31, 2008 at p. 1.

[21] October 27, 2008 John Buono memorandum to the Board.

times that were buffeting the assisted living industry and "imploding" the share prices of REITs like Ventas. This meeting took place on November 25, 2008, Ms. Bebo and Mr. Buono met with Ms. Cafaro and possibly others at Ventas, including Mr. Solari and Mr. Doman.

The meeting lasted only about 30 minutes. About half that time was taken up by Ms. Cafaro briefing Ms. Bebo on an active investor that had bought ALC's stock. The remaining part of the conversation touched on the effect of the recession on ALC and Ventas' businesses and high-level thoughts and questions about things each party could do to help the other through tough times.

It soon became clear, however, that Ms. Cafaro had no interest in a direct substantive dialogue with ALC, presumably because of ALC's insignificance to Ventas' business (as described above). One reason the meeting was so short is because Ms. Cafaro politely and professionally conveyed that she would not be meeting with Ms. Bebo again.

She told Ms. Bebo and Mr. Buono that Mr. Solari, the Managing Director-Acquisitions at Ventas, should be their point of contact for important matters in the relationship between the two companies. In that position, Mr. Solari was a senior executive of Ventas who reported directly to Ray Lewis, Ventas' Chief Investment Officer. Mr. Lewis reported directly to Ms. Cafaro.

This was confirmed by Mr. Solari, who testified that after the lease with ALC was executed, and around the time of Ms. Bebo's meeting with Ms. Cafaro, he served as ALC's "relationship officer." [22] He acknowledged he was responsible for the future business relationship with ALC. He also stated in his testimony that it would not be unusual or improper for ALC to discuss important matters related to the Lease covenants, such as waivers of or modifications to them.[23]

In fact, Mr. Solari provided corroborative testimony regarding Ms. Bebo's specific decision to discuss the employee leasing issues with him in the January 20, 2009 telephone conversation described below, despite highly suggestive questioning to the contrary from Staff:[24]

Q	Do you remember, did it seem odd to you that they were contacting you about operational issues with the lease? I can use the word unusual.
A	Yeah, not, not, really. Not really. I mean, they viewed me as their liaison, their point person at Ventas for any and all matters. Then no, I guess it wouldn't, it wouldn't be that unusual.

VI. Ventas Agrees to Permit ALC to Pay for Rooms for Employees Who Stayed or Had Reason to Stay at the CaraVita Facilities.

A. ALC learns that Old CaraVita had employees living at the CaraVita Facilities.

ALC learned in 2008 that Old CaraVita had permitted a handful of employees to live at the CaraVita Facilities. Ms. Bebo recalls discovering this in late 2008, after ALC had terminated the employment of one of these employees. The corporate office received an inquiry from the staff at the Facility about what should be done with respect to the employee's lease with the Facility, i.e. should the employee be permitted to remain a tenant at the Facility, be evicted, or some other course of action be taken.

[22] Joseph Solari Testimony Transcript at 49; *see also id.* at 34-35.

[23] *Id.* at pp. 36-39; *see also* John Buono Testimony Transcript at 49, 68-69.

[24] *Id.* at 72.

Ms. Bebo was told that there were several employees that were or had been living at the CaraVita Facilities. ALC and Ms. Bebo understood that these employees were included in both the occupancy and financial coverage ratio calculations in the covenant reporting by ALC and in past reporting by Old CaraVita.

After learning about these employee occupants, Ms. Bebo consulted with Mr. Buono, David Hokeness (ALC's internal auditor), and Mr. Fonstad about the effect of employee leasing under the Lease. Mr. Hokeness testified that in 2008, after the ALC board instructed Ms. Bebo and Mr. Buono to reach out to Ventas with respect to the covenants, they all met with Mr. Fonstad, in-house legal counsel, to discuss whether they can include employees in the covenant calculations, since the predecessor (Old CaraVita) was doing that.[25] He described the meeting as a "brainstorming session" where the group also discussed other options like prepaying the lease, consolidating rental payments, and providing discounted rates to improve occupancy.[26]

Mr. Fonstad, as ALC's general counsel, was asked to review the Lease and provide legal advice regarding the ability for ALC to rent rooms to employees. Mr. Fonstad provided his preliminary analysis in a January 19, 2009 e-mail, which was refined during discussions among Ms. Bebo, Mr. Buono and Mr. Fonstad, and their collective discussion with Mr. Solari on January 20.

B. Mr. Solari agrees to the employee leasing arrangement during a January 20, 2009 telephone call.

ALC scheduled a call for January 20, 2009 with Mr. Solari. As described above, Mr. Solari acted as the principal relationship manager for the Ventas/ALC relationship, and it was reasonable for ALC to rely on his authority in connection with the Lease. He had at least "apparent" authority to bind Ventas. Ms. Bebo believed she had a good working relationship with Mr. Solari.

Based on discussions among Ms. Bebo, Mr. Buono, Mr. Fonstad, and Mr. Hokeness, Ms. Bebo had decided to discuss two principal matters during the January 20 call with Mr. Solari: the opportunity to partner with a hospice company at the Peachtree Estates Facility and employee leasing at all of the CaraVita Facilities.

Ms. Bebo has testified extensively about her recollection of the call with Mr. Solari, which is only summarized here. The call took place on January 20, 2009 by teleconference on a speakerphone in Ms. Bebo's office. Ms. Bebo, Mr. Buono and Mr. Fonstad participated from Ms. Bebo's office. Mr. Solari was the only participant from Ventas.

During the call Ms. Bebo told Mr. Solari that ALC had identified a few employees who had been leasing units at CaraVita Facilities that carried over from Old CaraVita. Once Mr. Solari indicated he had no issue with the fact that employees had been living at the Facilities and included in the covenant calculations, Ms. Bebo described ALC's intent to initiate a broader employee leasing arrangement whereby ALC would have units available in the CaraVita Facilities for people who would have reason to go there. Mr. Solari asked about the types of people covered by the arrangement and said that the arrangement would be permissible as long as it was in the ordinary course of business, which Ms. Bebo was told by Mr. Solari meant that ALC should charge regular market rates and it should be limited to

[25] David Hokeness Testimony Transcript at pp. 229.

[26] *Id.*

employees or other people whose backgrounds were familiar to ALC and who ALC was comfortable being present at the Facilities.

When asked, Mr. Solari said that he did not care how many persons were covered by the employee leasing arrangement, he did not need or want them to be reported separately, and he confirmed that the units covered by the arrangement would count toward the occupancy and coverage ratio covenants. Ms. Bebo told Mr. Solari that ALC rather than the employees would pay the rent, and that unoccupied rooms would be available for employees rather than them living full-time at a property. Mr. Solari did not ask many questions, and was readily agreeable to the practice.

In contrast to Ms. Bebo's detailed recollection of the telephone conference, the other participants have virtually no recollection of the substance of the call. Mr. Solari testified that he could not independently recall anything that was said during the call.[27] When shown Ms. Bebo's e-mail to Mr. Solari that summarized the discussions on the call Mr. Solari testified:[28]

Q	If you turn to the fifth paragraph, which is the first paragraph on the second page. It reads, in additional [*sic*] to the potential hospice lease, we are also confirming our notification of our rental room to employees. We confirm that all rentals are in the ordinary course of business, dot, dot, dot. What did you understand that paragraph to mean.
A	I don't recall.
Q	You don't recall at all?
A	No.

Mr. Solari did acknowledge that he had a "very vague, vague recollection" that Ms. Bebo mentioned something about ALC employees staying at the CaraVita properties during the call but he could not "remember any specifics."[29] He thought he was primarily in "listening mode," while Ms. Bebo did most of the talking.

However, despite Mr. Solari's unambiguous testimony that he recalled virtually nothing about the substance of the conversation, Staff persisted with further questioning of Mr. Solari suggesting Ms. Bebo's recollection of the call was inaccurate. Mr. Solari indicated he "would not" have agreed to anything related to employee leasing during the call, and that he "would not have had authority" to agree to any understanding related to the covenants. But where he has no recollection of the call, what he "would" have done is irrelevant and likely inadmissible.

Mr. Buono, based on the limited testimony he has provided thus far, appears to have a less detailed recollection of the call as well. His testimony, however, corroborates a number of key facts. First, Mr. Buono confirmed that ALC's general counsel, Mr. Fonstad, was present for the call although unannounced to Mr. Solari.[30] Mr. Buono confirmed that Ms. Bebo informed Mr. Solari that the prior

[27] Joseph Solari Testimony Transcript at 58-62.

[28] *Id.* at 60.

[29] *Id.* at 62.

[30] John Buono Testimony Transcript at 189. Mr. Fonstad believes he was not on the call, but testimony with respect to the entire subject matter is not credible and his recollection appears to have failed him entirely. For example, he testified that he has no recollection of any follow up regarding the inclusion of employees as occupants for Covenant calculation purposes following a late January e-mail that he prepared (Testimony Transcript at 28-29), yet this is contradicted by disclosure committee minutes throughout 2009 and the testimony of others that attended those meetings . He also testified that he does not recall ever seeing the February 4 e-mail to Mr. Solari (*id.*), which is also demonstrably incorrect. He says that he did not

lessee had employees living in some of the rooms at the CaraVita Facilities, that they were included in the covenant calculations, and that ALC would also like to include employees who might stay at the facilities.[31] He confirmed that she told Mr. Solari that the ALC employees would be included in the covenant calculations.[32] He confirmed that they discussed the requirement that rooms related to the employee stays be at a "street rate" like an arms' length transaction.[33] Beyond those details, Mr. Buono testified that he does not "recall a whole lot else being said. Joe just kind of saying okay and Joe saying can you just put that all in writing. Because in connection with that we were also discussing other issues."[34]

In Mr. Buono's responses to other specific questions about the content of the conversation, such as the issue of the number of employees that could be included, it is unclear whether he is denying certain topics were discussed or whether, consistent with his earlier testimony, he simply did not recall them being discussed. Mr. Buono's testimony on this subject concluded with the following:[35]

Q:	...What was your understanding of what the employee arrangement would look like based on the phone call?
A:	My, my impression of it was that it was going to be that our employees were staying there in lieu of hotels and that they would be, rather than having them go to a hotel and being reimbursed or having them go to our apartments and pay for it, and then submit an expense report, that it would be paid directly by ALC.
Q:	And, your understanding was that Joe Solari was not concerned with that type of arrangement?
A:	He showed no concern on the phone or on following correspondence.

C. Ms. Bebo's notes of this key discussion are missing, along with a host of other materials.

Ms. Bebo believes she could substantiate her recollection of the call if ALC had produced the notes Ms. Bebo took during the call. However, there is a significant amount of documents and information that Ms. Bebo once possessed or had access to in her capacity as CEO of the Company, that have neither been provided to us nor produced to the SEC. In particular, as we have discussed with Staff, Ms. Bebo was a meticulous note-taker, typically on legal pads, but also in her board books. Based on her notes that have been made available to date, there appear to be pages removed from her note pads and entire pads missing, and as a result we have not been able to review notes for key dates relevant to the matters being investigated. We do not believe that Staff has been able to review these notes either.

---

approve ALC utilizing non-residents to meet the covenant calculations and denies ever knowing employees were used in the calculations (*id.* at 31-32, 35-36), but this is again demonstrably false given is role in the discussions at the disclosure committee. As an indication of his suspect recollection, Mr. Fonstad could not recall that he was the chair of the disclosure committee. *Id.* at 44.

[31] *Id.*

[32] *Id.* at 191. "Q: So, your memory is that she said we would also like to include employees that were living in the properties as occupants for purposes of the [covenant] calculation? A: Yeah, I don't remember the exact words. I think the, the wording in the confirmation e-mail is probably consistent with what the, what the discussion was."

[33] *Id.* at 193.

[34] *Id.* at 189-90.

[35] *Id.* at 194.

The missing notes include those from Ms. Bebo's key conversation with Mr. Solari. If litigated, we will be able to produce at least one witness - and possibly more - that would testify that Ms. Bebo's notes from this conversation existed in the months prior to her termination and even provide certain details about the content of those notes. In addition, Ms. Bebo took notes of her February 2009 conversation with ALC Vice Chairman Mel Rhinelander (described below) and took notes in her board books based on what transpired during ALC board meetings. In the course of reviewing documents at the offices of counsel to the Company, Ms. Bebo identified isolated pages of her board books with her handwriting that had been apparently torn from the board books she maintained in her office.

D. Ms. Bebo sends a confirmatory e-mail to Mr. Solari regarding employee leasing and Ventas makes no objection to the arrangement.

During the call, the parties agreed that ALC would send a follow-up e-mail to Mr. Solari regarding the hospice proposal discussed during the call. Ms. Bebo, Mr. Buono and Mr. Fonstad decided that this e-mail would also include a discussion of employee leasing. In addition, Mr. Fonstad no longer felt it necessary to send the formal notice described in his January 19 e-mail, and both Ms. Bebo and Mr. Buono believe that Mr. Fonstad prepared a draft of the e-mail, which was reviewed by Mr. Buono before being sent to Ms. Bebo. Ms. Bebo then sent this e-mail to Mr. Solari on February 4, 2009, and forwarded the as-sent version to Mr. Fonstad the next day.

Consistent with the January 20 call, Ms. Bebo's February 4 e-mail mostly covered the hospice proposal. One paragraph addressed the employee leasing arrangement. It stated that ALC was "confirming our notification of 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."

Upon receiving the e-mail, Mr. Solari forwarded it to Mr. Doman, the senior executive in charge of Ventas' asset management function, Mr. Johnson, an asset manager assigned to ALC's account, and Joseph Sims, an asset manager analyst assigned to the ALC account. <u>Thus, every senior executive and key Ventas employee with direct responsibility for the CaraVita Facilities and the Lease was aware of ALC's confirmation of the company leasing rooms related to employees as occupants</u>. Mr. Solari also responded back to Ms. Bebo's e-mail indicating Bill Johnson would be following up on any issues related to it. Mr. Solari raised no concern with any part of its content. Ms. Bebo forwarded this e-mail to Mr. Fonstad. A week later, on February 13, Mr. Johnson sent an e-mail back to Ms. Bebo, indicating no objection to the employee leasing subject and stating he would like to set up a call to discuss the hospice opportunity.

The February 4, 2009 e-mail clearly put Ventas on notice regarding employee leasing by ALC. The e-mail states that it is "confirming" ALC's "notification" of employee leasing. From the text of the e-mail, it should have been clear to Ventas that ALC was notifying of actual employee leasing rather than a proposal to further discuss the topic. The text of the February 4, 2009 e-mail is not inconsistent with ALC paying for rooms that were available for employees. It is described as "our rental" of rooms to employees as occupants of the Tenant and "rentals related to employees." Other than ordinary course terms, there is no limit on the scope or operation of employee leasing in the e-mail.

From Ventas' perspective, it should not have mattered whether employees paid the rent to lease units or ALC paid the rent to have units used by or available to employees. In either case, these units would not continue to be occupied at the end of the lease term or if Ventas otherwise took over operation of the properties. If Ventas was really concerned about employee leasing, the Solari call and

February 4 e mail was sufficient for it to trigger questions. If for some reason Ventas did not understand the import of the February 4 e-mail, then at most there was a misunderstanding between ALC and Ventas about the effect of employee leasing under the lease.

Numerous Ventas executives with direct responsibility for the Lease received the e-mail, yet none asked any questions or raised any issues about it. Mr. Doman and Mr. Johnson confirmed this in their testimony. They also testified that they simply missed the discussion of employee leasing in the e-mail and would never have agreed to the concept.[36] This is inconsistent with their testimony that Ventas was keenly aware of ALC trending toward a default on the Lease covenants, that Lease covenants were very important to Ventas, and that when presented with the e-mail in their testimony that it appeared to be a highly unusual request. Consequently, it is not credible that they simply "glossed" over that part of the e-mail.

Rather, Ventas' actions in failing to question or object to the practice are entirely consistent with providing flexibility on the covenants and the operations in light of the fact that there was no risk of ALC's non-payment of rent and the fact that Ventas' primary focus in operating its business at this time was on generating liquidity and cash coming into the company (as stated in their SEC filings at the time and in statements to ALC). It would be contrary to that operational focus to pull the plug on an operator that was flush with cash and liquidity and presented no risk of non-payment.

In any event, what Ventas personnel thought, but did not express to ALC, and how they "would have" viewed the e-mail had they focused on it is irrelevant. The fact is that any reasonable person in management at ALC would have concluded that ALC and Ventas had an understanding regarding the effect of the employee leasing arrangement under the Lease. Ms. Bebo genuinely and reasonably believed the same, and here subsequent conduct and statements while at ALC were consistent with that belief.

VII. ALC's Implementation of the Employee Leasing Arrangement.[37]

After the January 20 call and the February 4 e-mail, ALC took steps to implement the employee leasing arrangement based on the terms communicated to Mr. Solari. ALC did not explore any other options for compliance with the occupancy and coverage ratio covenants in the Lease, including, but not limited to, unilaterally removing 10% of the units from the count or calculating the occupancy rate using the ratio of people to units, because ALC believed it had an agreement with Ventas regarding employee leasing.

A. ALC Board members direct Ms. Bebo to utilize the employee leasing arrangements.

Before implementing the employee leasing arrangement, Ms. Bebo discussed the arrangement with Mel Rhinelander, Vice Chairman of ALC's Board of Directors, who then spoke with David Hennigar, Chairman of ALC's Board of Directors, and they directed her to utilize the employee leasing arrangement.

---

[36] Timothy Doman Testimony Transcript at 97 (stating he does not recall Ventas responding to Ms. Bebo's e-mail); Bill Johnson Testimony Transcript at 91-93.

[37] As used herein, reference to "employee," "employee leasing," or similar language 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.

This discussion occurred on February 23, 2009, before the board and audit committee meetings scheduled for that day. Ms. Bebo, Mr. Buono and Robin Herbner, ALC's Field Accounting Manager, met with Mr. Rhinelander in Ms. Bebo's office. Ms. Bebo and Mr. Buono described the discussion with Mr. Solari during the January 20 call in detail consistent with the description above and provided Mr. Rhinelander with a copy of the February 4 e-mail to Mr. Solari. They discussed employee leasing as a way for ALC to comply with the occupancy and coverage ratio covenants in the Lease as compared to other alternatives, including approaching Ventas with a request for a waiver or amendment to the Lease.

Mr. Rhinelander then left Ms. Bebo's office to speak with Mr. Hennigar about the matter. Mr. Hennigar was at ALC's offices for the Board meeting that day. When Mr. Rhinelander returned to Ms. Bebo's office after speaking with Mr. Hennigar, he indicated that Mr. Hennigar had chosen to move forward with employee leasing as they had discussed. Later in the day, during the Board meeting when Ms. Bebo suggested discussing alternatives for Lease compliance with the full Board, Mr. Hennigar indicated that it had already been discussed. As a result, Ms. Bebo was led to believe that the rest of the Board endorsed employee leasing that day.

B. ALC accounting staff sets up procedures for employee leasing arrangement.

After the meeting on February 23, ALC proceeded to implement employee leasing under the Lease. ALC included some employees in the covenant calculations in the fourth quarter of 2008 based on the number of days they actually stayed at the Facilities. The compliance certification documents relating to the fourth quarter of 2008 were sent to Ventas on February 12, 2009. After approval of employee leasing by Mr. Hennigar and Mr. Rhinelander as described above occurred on February 23, ALC fully implemented the employee leasing arrangement as had been communicated to Ventas. ALC thus stopped collecting information about actual stays by employees, and tracked only employees that had a reason to travel to the Facilities.

Mr. Buono and the accounting staff under his supervision set up the procedures for implementing employee leasing. Although not necessary for Lease compliance because Mr. Solari specifically indicated he did not want ALC to separately report rentals related to employees, these procedures included quarterly lists of employees who went or had a reason to go to the CaraVita Facilities. The accounting staff maintained the list of employees for purposes of internal tracking and reporting to GT, and they periodically asked Ms. Bebo to add names to the list where appropriate.[38] Ms. Bebo would do so based on the understanding from the January 20, 2009 call with Mr. Solari that such employees would be limited to those with a reason to go to a CaraVita Facility. Since unoccupied units were made available to ALC for such purposes, there was no need to track actual days stayed by any such employees. If during a quarter it was determined that an employee had or would have a reason to go to a CaraVita Facility, such employee could go on the list for the entire quarter and remain on the list for subsequent periods. Although Ms. Bebo would occasionally remove a name from the list where she noticed that a person on the list would no longer have a reason to go to a property (e.g., a former employee), she did not review the list for this purpose and understood that other employees had been doing so as they had brought discrepancies to her attention from time to time. Grant Thornton also, on

[38] Mr. Buono basically confirmed his understanding that the standard, based on the discussion with and follow-up e-mail to Mr. Solari, was that an employee could be included if he went to the facility or had reason to be at the facility in the course of performing his job function. John Buono Testimony Transcript at 128, 131-32. Specifically, at page 128 of his testimony transcript, he stated "the qualifications were that they be at the properties, <u>or had reason to be there</u> and, and, you know, essentially might not have been there to us not knowing. You know, if they didn't show up, they were sick, they were, you know." (emphasis added)

occasion, told ALC that an employee should be removed from the list because he or she no longer worked there.

Ms. Bebo also relied upon Mr. Buono and the accounting personnel to handle the accounting treatment of the employee leasing and the quarterly certification process with Ventas. Ms. Bebo was aware that employee leasing transactions between the ALC parent and the subsidiary lessees of the CaraVita Facilities would be eliminated in consolidation and thus would not affect ALC's public reporting. The finance personnel set up an intercompany account, called the "997" account, for that purpose. However, Ms. Bebo was not involved in the accounting or reporting of the employee lease transactions at the subsidiary level for purposes of reporting to Ventas. Ms. Bebo does not recall being directly involved in the Ventas compliance certification process at any time.

Enforcement Staff has indicated that there are several problems with the lists, such as employees remaining on the list after they ceased employment, or being on the list for a full quarter when they were hired mid-quarter. Any person on the list who may be considered problematic was immaterial given ALC's discretion to reduce the number of operational beds by 10%, as noted above, and there were additional people that could be put on the lists, as noted below. Staff has also indicated that people on the lists who did not travel to the facilities commensurate with the amount of time for which they are listed may be problematic - however, that is not the case because this was not the standard by which people were to go on the lists. Consistent with ALC's agreement with Ventas, people only needed a reason to be expected to travel to a facility to go on the list for that facility. We have not had unfettered access to the employment information and travel records to address Staff's contentions with greater specificity.[39] But in our brief time with the lists, we identified several errors, and we have unsuccessfully tried to obtain the lists and other travel-related information from ALC (including copies of SEC Exhibits 506 and 507).

However, although Staff has poured through these lists in great detail and with 20-20 hindsight, they must also be viewed in the context of this having been a very small part of ALC's business and a very small part of Ms. Bebo's job responsibilities. As she testified, she did not take a great deal of time in providing her input and she would have relied on personnel in the accounting department to raise issues with the lists as necessary.

As a factual matter, we believe that there are at least 12 to 14 employees in positions at the regional level and above that had reason to go to each of the CaraVita Facilities throughout this time period, and likely did stay at CaraVita Facilities on average once per quarter. Based on the understanding reached with Ventas, ALC could have simply chosen from this set of 12 to 14 employees. As we understand it, ALC did not allocate more than this number of employees to any single Facility in any single quarter.

VIII. Subsequent Communications With Ventas.

After the January 20 call and the February 4 e-mail, Ms. Bebo believed that employee leasing under the Lease was settled and did not see any reason to subsequently re-open the issue with Ventas.

[39] However, we do note that the shear length of the travel records contained in Exhibit 507 does support the conclusion that there were a lot of employees travelling to the CaraVita Facilities during this time period.

A. Discussions regarding potential purchase of New Mexico properties.

In the weeks following the February 4 e-mail to Mr. Solari, ALC and Ventas also discussed a potential purchase by ALC of two properties owned by Ventas in New Mexico. At the time of the initial communications on the topic, ALC had not yet determined to rely on employee leasing for covenant compliance under the Lease, as that decision was not made until after consultation with Mr. Rhinelander and Mr. Hennigar before the February 23 Board meeting.

As noted above, Ms. Bebo believed in maintaining communications with Ventas regarding potential areas of mutual opportunity. With the challenging financial conditions Ventas was facing in early 2009 and the impending bankruptcy of one its largest operators (Sunrise Senior Living), Ms. Bebo believed that a purchase of the two New Mexico properties by ALC might be advantageous to Ventas. Given that understanding, Ms. Bebo believed that ALC might be able to obtain relief from the coverage ratio covenants in connection with a purchase of the New Mexico properties.

In a February 19 e-mail, Ms. Bebo proposed a purchase price of $65,000 per unit, which is what Mr. Solari had indicated would be an attractive price, plus temporary relief from the coverage ratio covenants. Even with employee leasing in place, relief as to the coverage ratio covenants would be appealing to ALC. First, it would provide ALC with more flexibility in pricing for residents at the CaraVita Facilities. While employee leasing was at the full market rate, it did not provide ALC with any outside revenues, which could adversely affect the operating income realized on ALC's consolidated financial statements. A discounted rate from an outside resident could provide ALC with more revenue and operating income, but could jeopardize compliance with the coverage ratio covenants. Second, covenant relief would reduce management time and effort on tracking and certifying covenant compliance, particularly with respect to the ALC accounting personnel.

Ms. Bebo *did not* propose relief with respect to the occupancy covenant in connection with negotiations regarding the New Mexico properties. Ms. Bebo's February 19, 2009 e-mail to Mr. Solari, which was drafted by Mr. Fonstad, contained ALC's covenant proposal and did not mention relief as to the occupancy covenant at all, focusing instead on the 12-month facility and portfolio coverage ratios.

Staff has suggested that by using the term "financial covenants" in the e-mail that ALC intended to request that the occupancy covenant would be waived entirely (despite making no mention of the occupancy covenant). No witness has supported this suggestion, including Ventas witnesses who, despite highly suggestive questioning to the contrary, stated that they understood that ALC was not requesting any modification to the occupancy covenant as part of the proposal contained in the e-mail.[40]

---

[40] *See, e.g.*, Bill Johnson Testimony Transcript at 117:

> Q: There's a reference in the last sentence of the first paragraph, to the current financial covenants in the lease. If you look at the lease, the lease defines financial covenants as both the occupancy and the coverage covenants. It calls them all financial covenants.
>
> A: Coverage ratio, portfolio and occupancy.
>
> Q: Right, it's all under the heading of --
>
> A: Right. Okay.
>
> Q: I was wondering if your understanding, when you first read this e-mail, was that they were seeking a waiver of the occupancy covenant in its entirety, or if they were just seeking an amendment to the, as to the coverage ratio?
>
> A: Can you ask that one more time?

In the discussions related to the New Mexico facilities, Ventas' position indicated there was flexibility in the covenants - they expressed a willingness to entirely waive aspects of the coverage ratio covenants for multiple years. In the end, however, discussions with Ventas regarding the New Mexico properties broke down due to a failure to reach agreement on the financial terms of the transaction. Ventas made a counterproposal at $70,000 a unit and demanded ALC purchase the Peachtree Estates facility at $134,159 a unit.[41] Although Ms. Bebo thought the price for Peachtree and the New Mexico properties approximated fair market value, Ms. Bebo knew that Mr. Hennigar, and therefore the rest of the Board would not accept such terms (in particular the Peachtree price) as they would be dilutive as compared to the price per unit implied by the market price of ALC's Class A Common Stock.[42] This issue came up frequently in that Ms. Bebo and Mr. Buono generally preferred the operational flexibility of owning properties, while Mr. Hennigar in particular was reluctant to purchase properties at a price that would be dilutive to the price per unit implied by the market price of ALC's Class A Common Stock.

B. Communications regarding CaraVita Facilities.

Ventas regularly communicated with ALC on matters relevant to the Lease and the CaraVita Facilities. In fact, Ventas was much more intrusive in the frequency and scope of its questions and information requests than landlords of other properties ALC leased.

Many of Ventas' information requests related to market conditions, ALC's business strategy and sales efforts, and ALC's operations outside of the CaraVita Facilities. In this regard, Ms. Bebo was aware that Ventas had its own assisted living operations in ALC markets throughout the United States, and thus was a competitor to ALC. Additionally, in 2011 Ventas acquired approximately 118 senior living facilities from a private company called Atria Senior Living, Inc., with many of the facilities located in markets where ALC also operated.

Ms. Bebo understood Ventas would use the information for its own general business purposes, not necessarily to compete directly with the CaraVita Facilities but to use or share with its other operators and lessees. This would, of course, allow those operators to compete better with ALC's other facilities. Mr. Buono viewed Ventas' inquiries similarly.[43] Mr. Johnson confirmed that Ventas shared

---

Q: What was ALC requesting? Was ALC, by asking that the financial covenants be replaced, was it asking that the occupancy covenants be removed in their entirety, because they were one of the financial covenants? Or were they just asking that the coverage covenants be, be changed or amended?

A: I would've, from reading this, it looks to me like it would just be asking for these coverage ratios.

Q: So the request has nothing to do with occupancy covenants?

A: That's what, that's the way I interpret it.

Q: It's your understanding?

A: Yeah.

[41] As with other key correspondence with Ventas during this time period, Ms. Bebo forwarded the Ventas e-mail counter-proposal to Mr. Fonstad.

[42] The per unit implied share price traded at a discount because of the dual class structure of ALC's stock with the Class B Common Stock having greater voting rights and providing Mr. Hennigar with effective voting control of ALC.

[43] Buono Testimony Transcript at 52-53, where he explained the reasoning behind giving as little information to Ventas as possible: "We have had meetings with Ventas in the past where they have opening discussed what competitors are doing and we, Laurie's opinion was we're not going to give them anything that they can discuss in front of our other competitors since they lease with other folks."

information and intelligence it gathered among its operators, and indicated that Ventas wanted as much operational information as an operator was willing to provide.[44] Describing the last sentence of an e-mail he wrote that referred to how Ventas could help ALC in its operations, he states, "you know, you, with having multiple operators that, under Ventas, you, you see what's working and what doesn't and then you hopefully share those best practices."[45] The implication from many of Ventas' requests was that what Ventas was really interested in was market information.[46]

In addition, because ALC was also a publicly traded company, it had its own concerns about divulging any non-public information about its operations to Ventas.

Consequently, ALC's practice was to give general, standard answers to Ventas questions to avoid competitive harm, focusing on high-level marketing/operational developments that would not include sensitive information. For example, when Ventas asked about occupancy changes, ALC would typically respond by discussing changes in marketing personnel and general statements about sales initiatives.

In communicating with Ventas about occupancy statistics during quarterly calls and other communications, it never occurred to Ms. Bebo to address employee leasing rather than the types of marketing developments that ALC would normally address. Nor do counterparties to an agreement normally re-visit its terms in the ordinary course of business communications. For example, when Humair Sabir asked for "color" about increases in occupancy at a number of CaraVita Facilities on July 28, 2009, ALC responded by providing general information about sales personnel changes, performance plans and other information consistent with ALC's typical answers to such questions.[47] Consistent with these requests being for additional "color," Ventas accepted ALC's answers without further inquiry.

Moreover, with respect to this particular communication, ALC had just months before discussed the employee leasing with Mr. Solari and provided the confirmatory e-mail that went to three employees in Ventas' asset management function. Thus, ALC reasonably concluded that Ventas was not looking for a discussion of employee leasing - they knew there were employees included in the counts and Mr. Solari had indicated that he did not want them separately reported. The responses to Ventas addressed the types of business details that Ms. Bebo believed Ventas was generally interested in. Ms. Bebo took a similar approach on those occasions when she participated in subsequent quarterly conference calls with Ventas.

IX. Personnel Involved in ALC's Disclosure Process Considered the Lease Disclosure in Light of the Employee Leasing Arrangement, and No One Suggested a Different Disclosure.

ALC's SEC disclosure process with respect to the employee leasing arrangement was transparent. In 2009 and 2010, ALC's Form 10-Ks and Form 10-Qs were prepared by a team that included ALC's general counsel Eric Fonstad, ALC's director of financial reporting John Lucey, ALC's internal auditor David Hokeness, and Mr. Buono. Ms. Bebo, of course, also reviewed, approved, and provided Sarbanes-Oxley certifications for the filings.

---

[44] Bill Johnson Testimony Transcript at 35, 50-51.

[45] *Id.* at 50-51.

[46] For example, in August 2008 Ventas' asset manager sought market-based information from ALC specifically for use by Ventas' CEO in its quarterly earnings calls with equity analysts. *See* VSEC0011092-98.

[47] Similarly, referring to one of the quarterly conference calls in 2008, Mr. Johnson indicated that the purpose of the calls and Ventas' questions were to just "get some more color on the numbers." Bill Johnson Testimony Transcript at 64-65.

The central clearinghouse for key disclosure items in the filings was ALC's disclosure committee, Chaired by Mr. Fonstad, and that was no different with respect to compliance with the Lease and employee leasing. Ms. Bebo had no role in or influence on the disclosure committee, as she was not a member of it. Thus Messrs. Buono and Fonstad must have reached the same understanding as Ms. Bebo of the contours of the employee leasing arrangement based on their participation in the call with Mr. Solari and the February 4 e-mail.

At virtually every meeting in 2009, the disclosure committee discussed employee leasing and the disclosure in the filings regarding compliance with the Lease, as set forth in the below summary of disclosure committee minutes:

Meeting Minutes	Reference to Employee Leasing to Meet Covenants
2/13/2009 (SEC Ex. 135)	"Ventas lease covenants continue to be monitored and correspondence between ALC and Ventas has occurred whereby the covenant calculations have been clarified as to census."
4/22/2009 (SEC Ex. 137)	Hokeness testimony indicates a similar disclosure was contained in these minutes.
7/30/2009 (SEC Ex. 138)	"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 Q3. No lease covenants violated."
10/29/2009	Same.

Put simply, consideration of the inclusion of employees in the covenant calculations for the Lease was a focus of repeated discussion at the disclosure committee. Mr. Lucey and Mr. Hokeness described those discussions and took comfort in the fact that legal counsel, Mr. Fonstad, was present and had been involved in vetting the practice from its very inception. For example, when Mr. Hokeness was asked why, as the internal auditor, he did not test the boundaries of the clarification ALC received from Ventas or the understanding that ALC had reached with Ventas, Mr. Hokeness emphasized that legal counsel's involvement in the practice dated all the way back to late 2008. He described a meeting in late 2008:[48]

> .... I was present at board meetings [in 2008] where management had been given some instructions with regard to the Ventas contract or arrangement.
>
> They were given some directives to go deal with them, specifically with Ventas. Shortly after that board meeting, I was called into an impromptu meeting with Laurie Bebo, John Buono, *I know one or both of the in-house legal counsel were at this meeting*, to discuss the board's directives at that meeting. The discussion focused on a number of topics, but one of them was well, the predecessor, Lessee was using employees, can we, what would keep us from using that...

At this meeting, they also discussed other options like prepaying the lease, consolidating rental payments, providing discounted rates to move the occupancy needle. It was a brainstorming session.

[48] David Hokeness Testimony Transcript at 229

Mr. Hokeness described how the "interactive, very free flowing" discussions at the disclosure committee meetings chaired by Mr. Fonstad gave him significant comfort:[49]

> Okay, and then, and now we are going into '09 and I am at the disclosure committee meeting for some of the same, similar topics have come up. There would have been negotiations and an agreement with Ventas. The same legal counsel is leading the committee disclosure meeting and going through the topics. I'm taking notes in connection with these, these, I'm familiar with the discussion points.
>
> I'm not intimately involved in the legal, legality of what the negotiations were, what the conclusions were, how they were documented, how they were approved, I wasn't aware, but I was aware that our legal counsel was very much privy and knowledgeable about the situation. And I don't, we did not be waiver [*sic* belabor] the specifics at the disclosure committee meetings, that I recall, so that was the mindset I would have been under during these meetings.

Mr. Lucey, ALC's director of financial reporting and the person responsible for managing the SEC disclosure and filing process, testified similarly. He testified that everyone on the disclosure committee seemed comfortable with the Ventas agreement. Lucey did not see the e-mail that reflected the agreement, but he understood (accurately) that legal counsel had seen it, was present for the discussion in the meeting, and seemed comfortable. They went through ALC's draft filings line-by-line in the committee meetings, and neither Mr. Fonstad nor anyone else objected at any point to the employee leasing practice or raised concerns about ALC's disclosures on Lease compliance.[50] Mr. Lucey and Mr. Hokeness did not raise any concerns about the disclosures even though Sean Schelfout and Robin Herbner had expressed concerns to them about the practice.[51]

Most significantly, no one involved in the disclosure committee (or any of the accounting staff) raised any concern about ALC's disclosure or the practice with Ms. Bebo.

X. In Addition to Legal Counsel and Other Members of the Disclosure Committee, ALC's Auditors and Board Knew About and Approved the Use of Employee Leasing to Meet Lease Covenants.

Once employee leasing was implemented, the ALC Board and Grant Thornton LLP ("GT"), were informed of the significant elements of the arrangement. Ms. Bebo was open and transparent with both the ALC Board and GT.

With respect to GT, Ms. Bebo understood they were reviewing the employee leasing from early on. In May 2009, during its review of the financial statements for the first quarter of 2009, GT asked for support on occupancy in the CaraVita Facilities. Mr. Buono and the rest of the ALC accounting staff handled the response, which included providing GT with a copy of the February 4, 2009 e-mail to Mr. Solari and the number employees included in the occupancy totals for the quarter. At about the

---

[49] *Id.* at 231. Mr. Hokeness also stated: "Going into this [disclosure committee meeting], I mean, I know where you are coming from today, but going into these meetings, this wasn't the first time this topic had come up. I had been in earlier meetings, this had been a discussion point. I had been, there had been meetings with Laurie, John, legal counsel to discuss, can we use employees in the buildings or not?"

[50] John Lucey Testimony Transcript at 29-36. Mr. Lucey explained he was comfortable with Mr. Buono's statements at a disclosure committee meeting about the covenant calculations "mostly because certainly everybody in the room was comfortable with it . . . with having legal counsel there . . . they were all comfortable with it." David Hokeness Testimony Transcript at 219-20.

[51] *See, e.g.* Lucey Testimony Transcript at 44; Hokeness at 191-92.

same time in April or May of 2009, Melissa Koeppel, the audit partner on the ALC engagement, met with Ms. Bebo in her office and they discussed some of the details of employee leasing. The context of that discussion revealed that Ms. Koeppel was familiar with the employee leasing process through her prior discussions with Mr. Buono. Although she was available and did not avoid further interactions with GT, Mr. Buono and the accounting staff were primarily responsible for working with the auditors. There is no evidence that Ms. Bebo attempted to improperly influence GT's view of the practice, discussions with GT about it, or the manner in which GT vetted the practice.

As part of its subsequent quarterly reviews, Ms. Bebo understood GT reviewed the lists of employees for the leasing practice at the CaraVita Facilities. By virtue of such review, GT must have been aware of the scope of employee leasing and the fact that not all of the employees on the list actually resided at the properties for the entire period as some employees would appear on the list for multiple properties and employees on the list included persons at ALC's headquarters who were familiar to GT.[52]

With respect to ALC's Board, Ms. Bebo recalls that employee leasing came up at a number of ALC Board or committee meetings and in individual discussions with Board members. In addition to Ms. Bebo and Mr. Buono discussing it, the GT audit partners also provided at least two presentations to members of the Audit Committee.

Mr. Hokeness confirmed in his testimony that at least as of mid-2009 the Chair of the Audit Committee was aware of the utilization of employees to meet the Lease covenant calculations. Mr. Hokeness stated that he would have a phone call with the Chair of the Audit Committee, Malen Ng, prior to each meeting to discuss certain topics. On one such call in mid-to-late 2009, he discussed with Ms. Ng the continuing decline of occupancy in the CaraVita properties. Ng asked if Hokeness had concerns and he told her that they were not concerned because they continued to add employees to the calculations.[53]

ALC Board members also received packages of financial materials that would show the impact of employee leasing at the CaraVita Facilities, including quarterly occupancy data and annual budget materials. For example, prior to quarterly meetings, the ALC Board would receive financial reports that reported occupancy data for the CaraVita Facilities with employees, as reported to Ventas, and without employees as included in ALC's public securities filings. Any director could have easily seen the differences in the occupancy numbers with and without employees. Notably, Messrs. Fonstad and Hokeness also reviewed all board packages, attended the Board meetings, and therefore were aware, or should have been aware, of the full scope of the employee leasing arrangement.[54]

DISCUSSION

The Staff is considering charging Ms. Bebo with alleged violations of (1) the anti-fraud provisions of the securities laws; and (2) Section 13 reporting obligations, including alleged Sarbanes-Oxley certification violations. As demonstrated below, there is no basis for any such charges.

---

[52] Sean Schelfout's testimony confirms that GT was aware of the employee leasing and did not express an opinion that the practice was inappropriate or impermissible. Schelfout Testimony Transcript at 64-66.

[53] David Hokeness Testimony Transcript at 98-100.

[54] As a member of the senior management team, Mr. Fonstad also received daily occupancy reports. For the CaraVita facilities, these reports would have been without employee adds.

PART I: THERE IS NO BASIS FOR FRAUD CHARGES AGAINST MS. BEBO

I. Elements of a Securities Fraud Cause of Action.

The Staff proposes to charge Ms. Bebo with violations of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. *See* 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. The SEC must prove that Ms. Bebo, with fraudulent intent to deceive investors, made a material misstatement, or omitted to disclose material information that she had a duty to disclose. *See Aaron v. SEC*, 446 U.S. 680 (1980); *Pugh v. Tribune Co.*, 521 F.3d 686, 693 (7th Cir. 2008).

II. ALC'S SEC Filings Contained No Actionable Misstatement Regarding Compliance With the Lease Covenants.

In each of its Quarterly Reports on Form 10-Q and Annual Reports on Form 10-K beginning with the Form 10-Q for the quarter ended March 31, 2008, ALC included a statement to the effect that ALC was in compliance with the covenants contained in the Lease as of the last day of its most recently completed fiscal quarter. It was included in the section titled "Future Liquidity and Capital Resources."

Beginning with the Form 10-Q for the quarter ended June 30, 2011, ALC added a statement that "[b]ased 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." ALC added this statement in response to a comment letter from the SEC staff dated July 21, 2011.

A. The Standard for Pleading and Proving Falsity of ALC's Opinion That It Was In Legal Compliance With the Lease Covenants.

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 Virginia Bankshares v. Sandberg*, 501 U.S. 1083 (1991); *Fait v. Regions Fin. Corp.*, 655 F.3d 105, 111 (2d Cir. 2011). Because a claim based on an opinion turning out to be incorrect would be impermissibly based on hindsight, the SEC will have to prove both that (1) that the opinion stated was objectively incorrect; and (2) that the speaker of the opinion knew that the opinion was incorrect or did not believe it was accurate herself. *Virginia Bankshares*, 501 U.S. at 1095-96.

There can be no question that ALC's statement that it was in compliance with the Lease covenants was a statement of opinion. Legal compliance with a complex lease, containing numerous irrelevant and inapplicable provisions, and containing significant ambiguity (as to occupancy) and discretion (as to coverage rations) in how covenants are to be calculated is undeniably a "matter of judgment."[55] An assertion of legal compliance cannot be definitively true or false at the time it is made except in the rare case in which a court has already definitively ruled on the legality of the issuer's actions. The ultimate accuracy of the stated belief hinges on future events and the decisions of counterparties, judges, juries, and regulators. Assessing legal compliance thus calls for an exercise of judgment about unknowable future events.

[55] The Restatement (Second) of Torts § 538A (1977) defines a statement of opinion as a statement of "the belief of the maker, without certainty, as to the existence of a fact" or of "his judgment as to quality, value, authenticity, or other matters of judgment." (emphasis added).

As set forth below, the SEC cannot establish that ALC's statement of compliance with the Lease was objectively incorrect. It was both literally true - Ventas had made no allegations that ALC was not in compliance with the Lease. Moreover, ALC had, even under a view of the facts most favorable to the Staff's interpretation of them, an understanding with Ventas to count employees in the covenants to some extent. Finally with respect to falsity, there is no question that Ms. Bebo subjectively believed that ALC was compliant with the Lease covenants because ALC had an understanding with Ventas regarding employee leasing. Because this analysis in many ways overlaps with an assessment of scienter, we address them together in Section IV below.

B. ALC's Opinion of Compliance With the Lease Was Objectively Correct.

There are three basic reasons why ALC's statements in its SEC filings were correct as a matter of objective fact.

First, as set forth above, the Lease was ambiguous with respect to what constituted "occupancy" or an "occupant" and ALC had discretion for how to calculate the occupancy rate. Section 8.2.5(d) of the Lease simply stated the required thresholds for the "minimum average occupancy rate." Other key terms used in the Lease were defined, but not occupancy. The Lease certainly did not expressly preclude counting units paid for by ALC for employees who stayed or had reason to stay at the CaraVita Facilities.

In fact, it was common for seniors to themselves pay for rooms at the CaraVita Facilities and other ALC buildings, even though those customers lived elsewhere during substantial periods of time. No one is suggesting that, despite their failure to actually "occupy" the units, that these units could not be counted toward the calculation of the occupancy covenant and the financial coverage ratios. And, there is nothing in the Lease that prevented ALC from doing the same in order for ALC's employees to use the units for ALC's own purposes.

ALC publicly reported occupancy based on rented units (i.e., commitments to pay for a unit for an applicable period),[56] and ALC generally did not have a reason to track the days a resident actually stayed in a unit for purposes of reporting occupancy. Ms. Bebo approached employee leasing under the Lease with the same mindset, focusing on ALC's payment of rent for the unit as the relevant factor.

The practice was also not prohibited by the "Primary Intended Use" covenant in Section 7.2.1 because the units were being used to improve the operations of the CaraVita Facilities and further their purpose of providing assisted living services. And, finally, ALC provided both verbal and written disclosure of the tenant's transactions with affiliates as part of the employee leasing arrangements.

Second, the evidence demonstrates that Ms. Bebo obtained clarification of an ambiguous Lease term and effectively disclosed how ALC intended to proceed with respect to including employees in the covenant calculations. With potential ambiguity in the Lease, Ms. Bebo and Mr. Buono first consulted with Mr. Fonstad, ALC's general counsel, and then spoke with Mr. Solari, a senior Ventas executive whom she was told was to be ALC's relationship manager, to confirm Ventas' agreement as to ALC's understanding of the effect of employee leasing under the Lease. During this call on January 20, 2009, Mr. Solari agreed to the relevant aspects to the employee leasing arrangement. We believe that Ms. Bebo's notes, if they were available, would support her recollection of the call with Mr. Solari.

---

[56] *See* ALC Form 10-K for the year ended December 31, 2011 at p. 24, which defines "census" as "the number of units rented at a given time" and "occupancy" as "the percentage of average daily census relative to the total number of units available for occupancy in the period".

On February 4, 2009, Ms. Bebo sent an e-mail to Mr. Solari, which was drafted by Mr. Buono and Mr. Fonstad, to confirm the understanding of ALC and Ventas regarding the employee leasing arrangement. This e-mail was forwarded to other key decision-makers at Ventas regarding the Lease, including Messrs. Johnson, Doman and Sims. Although this e-mail did not cover every point from the January 20, 2009 call with Mr. Solari, it clearly notified Ventas of a broad arrangement whereby ALC have rentals "related to" employees. It was not phrased as a proposal, but rather as a confirmation of something ALC would do, and indeed had been doing.

At that point in February 2009, ALC had a valid understanding with Ventas that the employee leasing arrangement complied with the Lease as written and units available for employee use could be counted toward compliance with the occupancy and coverage ratio covenants in the Lease. If Ventas were to have challenged employee leasing at any time, ALC could have referenced the potential ambiguity in the Lease and held Ventas to the parties' mutual understanding that occupancy was broad enough to cover employee leasing under the terms discussed between Mr. Solari on behalf of Ventas and Ms. Bebo, Mr. Buono and Mr. Fonstad on behalf of ALC. At a minimum, therefore, ALC would have had a reasonable defense in litigation related to any default alleged by Ventas, and the SEC is faced with the difficult proposition of litigating the reasonableness of ALC's defense to an underlying claim by Ventas to try and prove fraud under Section 10(b).

We think a fact-finder would conclude that ALC had a reasonable defense to any default asserted by Ventas, and the understanding was certainly sufficient for ALC to continue to state its opinion in SEC filings that it was in compliance with the covenants in the Lease for the relevant periods.

Third, it is undisputed that Ventas did not claim an event of default of any of the operating covenants related to the employee leasing issue until May of 2012.[57] Thus, it is undisputed that ALC was meeting the covenants in the Lease based on its use of employees in the occupancy and coverage ratios. Consequently, all of ALC's statements in its periodic filings were literally true, and the only question then is whether the securities laws required ALC to disclose facts with respect to how ALC was meeting the covenants. *See SEC v. Goldstone*, 952 F.Supp.2d 1060, 1222-24 (D.N.M. 2013); *Fulton Cty. Emp. Ret. Sys. v. MGIC Inv. Corp.*, 675 F.3d 1047, 1049-50 (7th Cir. 2012); *SEC v. Gabelli*, 653 F.3d 49, 57 (2d Cir. 2011).[58] And explaining how ALC met the Ventas covenants would not change ALC's reported occupancy or financial performance metrics in its public filings.

As set forth below, there was no duty to disclose information related to the basis for ALC's conclusion that it was in compliance with the Lease covenants.

III. ALC's Statements Of Opinion Concerning Compliance With The Lease Are Not Actionable As A Matter Of Law Because There Was No Duty To Disclose Immaterial Information Forming The Basis Of The Opinion Or Predictions About Behavior Of Its Contractual Counter-Party.

The materiality requirement protects investors or shareholders from being buried in an "avalanche of trivial information—a result that is hardly conducive to informed decisionmaking." *Basic*

[57] Even then, Ventas did not include any express allegations related to the employee leasing arrangements in its First Amended Complaint against ALC, filed May 14, 2012. Ventas' allegations relating to employee leasing were included in a letter to ALC dated May 9, 2012, which was disclosed in a Form 8-K filed by ALC on May 14, 2012.

[58] ALC's statements regarding compliance with the Lease was also accompanied by cautionary language in its periodic filings with the SEC, which warned investors that breaches of certain lease covenants could have a material adverse effect on ALC's business as a whole.

Inc. v. Levinson, 485 U.S. 224, 231-32 (1988) (quoting *TSC Industries v. Northway, Inc.* 426 U.S. 438, 448 (1976)). 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.'" *Id.*

In evaluating whether "soft" information related to a company's opinions or beliefs about a matter need to be disclosed, courts have found that the company does not need to disclose information that forms the basis of the company's opinion or judgment on the matter.[59] Requiring this type of detailed disclosure ensures that corporations are not subject to second-guessing in disclosure suits founded on opinions, which would prompt companies to "deluge investors with marginally useful information...." *Zaluski v. United American Healthcare Corp.*, 527 F.3d 564, 572 (6th Cir. 2008); *see also Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 514, 518 (7th Cir. 1989).

Consequently, where an issuer has a reasonable defense to an asserted breach of a material contract or to assertions of non-compliance with laws or regulations, there is no actionable claim under the securities laws where the issuer asserts it is in compliance with such laws or contract. *See Anderson v. Abbott Laboratories, Inc.*, 140 F. Supp. 2d 894, 906-07 (N.D. Ill. 2001) *aff'd at Gallagher v. Abbott Laboratories, Inc.*, 296 F.3d 806 (7th Cir. 2001). In *Anderson*, a regulatory body had already asserted that the company had breached regulations critical to the ongoing profitability of the business, but the company asserted in its public filings that it was in substantial compliance with the regulations. In dismissing the claim, the court stated:

> Abbott's maintenance of its innocence is not fraud. SEC rules do not create a duty to confess contested charges.... Where there exists a good faith dispute as to facts or an alleged legal violation, the [law] only requires disclosure of the dispute. There are good reasons for this limitation. A tender offeror should not be placed in a position of being forced to either admit liability, while he or she disputes it, or violate the securities law by failing to disclose the alleged and disputed violation. As long as the tender offeror discloses to the target shareholders that a good faith dispute exists as to an alleged violation of law, a shareholder has sufficient information to make a rational and informed decision. This same reasoning applies to proxy disclosures and should extend to 10(b) as well.

Id. (citations omitted); *see also Arazie v. Mullane*, 2 F.3d 1456, 1466-67 (7th Cir. 1993) (disclosures about compliance with gaming regulations were not misleading where there was "no document, meeting, or transaction which could or should have alerted [the company] that the [Gaming] Commission objected..."). Here there was not even a dispute to disclose, and ALC had a good faith basis to conclude that its practice was in compliance with the Lease.

The *Zaluski* case, however, is the case that is most directly on point. There, the court held that a healthcare company called United American Healthcare Corporation ("UAHC") was not liable for securities fraud as a matter of law based on allegations that it failed to disclose factual circumstances indicating that it may have breached a contract with a state agency <u>that represented the source of nearly all of its revenue</u>. *Zaluski*, 527 F.3d 574-75. UAHC's contract with the State of Tennessee provided it

[59] Hard information is factual or historical information that is objectively verifiable. *City of Monroe Employees Retirement System v. Bridgestone Corp.*, 399 F.3d 651, 669 (6th Cir. 2005). Soft information, by contrast, includes a company's subjective analysis, predictions and matters of opinion. *see City of Livonia Emp. Ret. Sys. v. Boeing Co.*, 711 F.3d 754, 758 (7th Cir. 2013) ("The law does not require public disclosure of mere *risks* of failure. No prediction - even a prediction that the sun will rise tomorrow - has a 100 percent probability of being correct."); *In re Donald J. Trump Casino Sec. Litig.-Taj Mahal Litig.*, 7 F.3d 357, 369 n.11 (3d Cir. 1993) ("soft information" is "statements of subjective analysis or extrapolation, such as opinions, motives, and intentions, or forward looking statements, such as projections, estimates, and forecasts").

was subject to immediate termination and imposition of a penalty if it made direct or indirect payments to a state employee. *Id.* at 568.

Despite these potential consequences, for approximately four years, UAHC retained and made monthly payments to a Tennessee state senator in violation of the contract. *Id.* The breach subjected UAHC to immediate loss of virtually its only source of revenue, and penalties of up to $4.2 million. *Id.*

When the payments to the state senator came to light, UAHC issued a press release claiming, falsely, that the payments were made for out-of-state consulting, which could arguably be construed as not violating the contract. UAHC's stock lost more than half of its value in a single day of trading when it later was announced that it had received an order of supervision from the state for violations of its agreement. *Id.* at 569.

In affirming dismissal of the complaint, the court reasoned that (1) UAHC's periodic filings with the SEC were not misleading for describing the company's key contract but failing to disclose the payments in violation of the contract because there was no duty to disclose the basis for the conclusion that the company was in compliance with the contract or a prediction with respect to how their counter-party would react to a disclosure to it of the payments; and (2) UAHC's press release mischaracterizing the payments to the state senator was not actionable because the undisclosed information that rendered the press release misleading related to UAHC's opinions and predictions about the *consequences* of the payment, not the payment itself.

The reasoning of the *Zaluski* court on both these points is highly instructive in evaluating the present situation.

A. There was no duty to disclose facts related to employee leasing as the basis for ALC's opinion that it complied with the Lease covenants.

In *Zaluski*, Plaintiffs argued that UAHC's quarterly and annual filings were false and misleading for failing to disclose the facts that constituted the breach of the agreement. *Id.* at 569. The filings discussing UAHC's contract with the state, as described by the court, were quite similar to ALC's disclosures about the Lease:

> UAHC referred to the existence of the TennCare contract, the terms of the contract, and the length of the renewed contract.... These statements contained a paragraph that disclosed that the license with Tennessee was subject to "denial, limitation, suspension or revocation if there is a determination that the plans are" not complying with the contract or statutes, or failing to provide the care expected under the contract.

Id. at 574. Plaintiffs alleged it was misleading to describe the contract that accounted for nearly 100% of the company's revenue, implicitly certifying it was in compliance with the contract, while failing to disclose the fact that it was making payments to a state senator that could constitute a breach of the contract.

The court dismissed the action and found that the consequences of the payments by the company were "the type of predictions and soft information that do not give rise to a duty of disclosure." *Id.* at 574. In contrast to a duty to disclose data contrary to a belief based on "objective fact" that does "not turn on decisions made by external parties," in *Zaluski* the "complained-of omission ... is that payments made to [the Senator] could have resulted in Tennessee's decision to void the contract or fine the company. There is no evidence that [defendant] believed either of these actions to be forthcoming." *Id.* at 576; *see also Boeing*, 711 F.3d at 758-59 (holding there was no duty to disclose potential problems

with meeting the predicted deadline for first flight of the Boeing 787 because "[t]here is no duty of total corporate transparency - no rule that every hitch or glitch, every pratfall, in a company's operations must be disclosed in 'real time,' forming a running commentary, a baring of the corporate innards, day and night."); *In re Bank of Am. AIG Disclosure Securities Litig.*, 2013 WL 5878814, *11 (S.D.N.Y. Nov. 1, 2013).

ALC's statements in its SEC filings concerning compliance with the Lease were statements of opinion regarding a legal contract. There was no duty to disclose the basis for ALC's conclusion - i.e. that it was meeting the covenants through the employee leasing arrangement. Both the opinion that it was in compliance with the covenants and the related opinion that the employee leasing was compliant with the Lease were inextricably intertwined with predictions about decisions made by an external party, Ventas. The predictive nature of the disclosures is amplified by the fact that the statement is included under the heading "<u>Future</u> Liquidity and Capital Resources." As in *Zaluski*, the statement is therefore not actionable.

But Ms. Bebo and ALC actually have a stronger argument that there was no duty to disclose information that may have contradicted their opinion that the company was in compliance with the covenants. Unlike the contract in the *Zaluski* case where UAHC's contract clearly prohibited direct or indirect payments to state employees, the Lease here did not define occupancy and did not clearly address whether employee lessees could be counted as occupants for purposes of the occupancy covenant, whether such employees paid rent themselves or ALC paid the rent to make units available for their use on company business.

Moreover, disclosure of the information in ALC's case was less material to its operations than in *Zaluski*. There, the company faced the loss of nearly all of its revenue if the state agency terminated the agreement; ALC would suffer minor losses in comparison. In a worst case scenario, Ventas had the right to accelerate ALC's rental payments and take over operations of the Cara Vita properties. In 2012, the accelerated rental payments, up to $21.6 million (assuming that such amount represented an enforceable remedy), represented less than 10% of ALC's 2011 revenue. Of course, the payments would be much less than the $21.6 million because Ventas would have a duty to mitigate its damages.[60]

ALC also may have been able to negotiate some other resolution to any assertion of default by Ventas, such as having ALC advancing a portion of the rent, escrowing funds, outright paying Ventas a fee, or purchasing the buildings so that ALC could convert them to more profitable independent living facilities.

B. There was no duty to disclose even if the SEC could establish that employee leasing was not in compliance with the Lease.

As noted above, in *Zaluski* the court found that UAHC made an affirmatively misleading statement when it claimed payments to the senator complied with the contract because he was compensated for work outside of the state. Nonetheless, the court concluded that the materiality of the misleading statement derives solely from the predictions regarding the actions of the UAHC's contractual counter-party. Thus it was not actionable. *Id.* at 575-76.

As with the contention that the company's periodic filings were misleading for its failure to disclose the payments to the state senator, the court found that the "affirmatively misleading" press

[60] Illinois law, the governing law under the Lease, imposes an non-waivable duty of mitigation on a landlord. 735 ILCS 5/9-213.1. Moreover, effect on earnings, if any, would be further mitigated by tax considerations.

release would only be materially misleading to the extent that the company predicted that its counter-party would take a certain action. *Id.* There, UAHC did not need to qualify its statements concerning its payments or the order of supervision because the consequence of its payments turned on decisions outside the control of the company. *Id.* If UAHC's payments constituted a breach of the agreement the state could terminate or impose a penalty, but there was no evidence that UAHC believed that either of those events were soon to occur. *Id.* Notably, the court reached this conclusion even though a potential breach of contract that exposed it to a loss of virtually all of its revenue and additional penalties.

Consequently, under *Zaluski*, even if one assumes that the employee leasing arrangement breached the Lease, there is no duty to disclose because the materiality of the information turned upon matters of opinion and prediction on a number of complex issues that were entirely outside of ALC's control, including (1) whether Ventas would have elected to enforce the covenants, in a manner contrary to the understanding previously reached with ALC, or negotiated some other resolution; (2) what remedies and damages Ventas would have chosen; and (3) the enforceability of Ventas' liquidated damages remedy as noted above.

There are reasons supporting the reasonable belief on ALC's part to not assume the worst case scenario. For example, Ventas had publicly disclosed that the purpose of its review process with its tenants was to monitor credit risk, and it is unlikely that Ventas would have terminated a lease where rent was guaranteed by a financially sound and highly liquid ALC. This is especially true in 2009, when the impact of the financial crisis and recession were prompting Ventas to focus on liquidity and cash flow in its business operations.

In addition, during negotiations regarding the New Mexico properties in 2009, Ventas had shown a willingness to grant ALC relief from the covenants in the context of receiving something beneficial out of the larger negotiation. It is reasonable to believe that Ventas would engage in a similar negotiation.

In the end, the cases like *Zaluski* recognize that the securities laws should prevent investors from being deluged with marginally useful information. This would be required if companies had to disclose minutiae about the basis for every opinion held by the company. For an allegation of fraud in this context, the SEC would essentially be asserting that Section 10(b) required that ALC had to disclose not only that it believed it complied with the covenants by including employees in the relevant occupancy and coverage ratio covenant calculations; the legal reasoning for why it believed employees could be counted; details about the specific communications with Ventas whereby it reached its conclusion that it had an understanding about the ambiguous language in the occupancy covenant; and its subjective predictions about what Ventas might do if it disputed ALC's interpretation of the Lease and characterization of the communications with Ventas; and finally the basis for any prediction on what remedies Ventas may or may not assert and whether they are enforceable.

Such forward-looking opinions and subjective conclusions cannot and should not support securities fraud claims. Indeed in *Boeing*, the Seventh Circuit rejected a duty to disclose minutiae about the circumstances that raised questions about the company's date for a predicted first flight. It stated:

> A more plausible inference than that of [securities] fraud is that the defendants, unsure whether they could fix the problem by the end of June, were reluctant to tell the world "we have a problem and maybe it will cause us to delay the First Flight and maybe not, but we're working on the problem and we hope we can fix it in time to prevent any significant delay, but we can't be sure, so stay tuned." There is a difference, famously emphasized by Kant, between a duty of truthfulness and a duty of candor, or between a lie and reticence.

711 F.3d at 758-89.

C. Investors did not care about Lease compliance, demonstrating the lack of materiality.

One indicator of 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). A corrective disclosure that has no appreciable impact on the price of stock is immaterial as a matter of law. *See Grimes v. Navigant Consulting, Inc.*, 185 F. Supp. 2d 906, 914 (N.D. Ill. 2002) (finding disclosure that resulted in stock increase made failure to disclose immaterial as a matter of law).

In this case, there is no indication that investors thought that compliance with the Lease was a material factor that would materially change their views of the Company and whether to buy or sell its stock. In fact, the Commission has the benefit of seeing the actual effect that a covenant breach disclosure had upon the share price. Our analysis of movements in ALC's share price surrounding the Company's disclosure of Ventas' initiation of a lawsuit for ALC's alleged breach of the Lease as a result of actions by state regulators with respect to licenses at the CaraVita Facilities shows that there was virtually no negative market reaction.

On May 4, 2012 ALC filed the Form 8-K announcing the Ventas litigation alleging ALC's default under the Lease and ALC's own internal investigation with respect to potential "irregularities" in reporting under the Lease. Although ALC's share price declined that day, it only dropped slightly below the May 2 close. This is important because ALC's stock increased substantially on May 3 as a result of the market interpreting ALC's announcement that it was postponing its earnings release as an indication of an impending sale of the Company. In addition, the stock prices of ALC's peers generally declined on both May 3 and May 4 making the share price movement of ALC's price on May 4 even more insignificant.[61]

Moreover, in the days following the May 4 announcement of the Ventas litigation and potential "irregularities" in Lease reporting, ALC's stock immediately bounced back to where the share price closed on May 2. By May 9, ALC's stock traded above the May 2 close. And finally, when ALC disclosed in a May 14 8-K that Ventas had alleged in a May 9 letter that counting employees as bona fide rentals was improper, ALC's stock declined only slightly from the day before (2.3%). This is even more insignificant because each of its peers declined that day as well.

This is not surprising given the relative insignificance of the CaraVita Facilities when compared to the size of ALC's overall operations. Not surprisingly, investors focus primarily on how the Company's overall operations are performing - Company-wide occupancy, revenue, expense, and margin trends, and of course profitability. This is reflected in comments the Company received from one of the equity analysts covering ALC's stock in the immediate wake of the Ventas lawsuit and internal investigation announcements. This analyst stated in a May 16, 2012 e-mail to Ms. Bebo that "I understand if you can't talk about the Ventas lawsuit in great detail, but you can't hide either. Moreover, <u>properties under the Ventas lease appear to have minimal impact on overall operations</u>."[62]

---

[61] Peer group being defined as Brookdale, Emeritus, Five Star, Sunrise, and Capital Senior Living as used in the performance graph in Item 5 of ALC's Form 10-K for the year ended December 31, 2011.

[62] *See* ALC00160118 (emphasis added).

In addition to demonstrating the lack of materiality of the alleged undisclosed information, this also shows that no investors were harmed by anything related to the employee leasing practice. ALC's stock performed generally in line with its peers throughout 2012, until ALC decided after Ms. Bebo left to significantly alter the cost structure of the Company in order to address supposed "quality of care" issues. Issues that had nothing to do with the employee leasing practice. Consequently, the SEC would be faced with bringing a case regarding an obscure three lines in ALC's SEC filings, based on alleged non-compliance with a complex and ambiguous Lease, where investors showed they did not care about compliance with the Lease and no investors were harmed. No reasonable jury is going to find a securities fraud violation under these circumstances.

IV. There Is No Evidence That Ms. Bebo Acted With The Requisite Level Of Scienter To Support A Section 10(b) Claim.

The evidence shows that Ms. Bebo genuinely and reasonably believed that the employee leasing arrangement implemented by ALC complied with the terms of the Lease. Her conduct and statements while at ALC were consistent with that belief and there is no evidence that effectively contradicts it.

The Supreme Court has held that scienter 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, 213-14 (1976). This requirement applies to SEC enforcement actions as well as private actions. *Aaron v. SEC*, 446 U.S. 680, 695 (1980). In *Hochfelder*, the Supreme Court defined scienter as "a mental state embracing intent to deceive, manipulate, or defraud," 425 U.S. at 193 n.12 (1976). Some lower federal courts have held that this standard can be met by a showing of "extreme recklessness." The Seventh Circuit has held that scienter requires "recklessness so severe that it is the functional equivalent of intent." *Searls v. Glasser*, 64 F.3d 1061, 1066 (7th Cir. 1995), citing *Ambrosino v. Rodman & Renshaw, Inc.*, 972 F.2d 776, 789 (7th Cir. 1992); *Sundstrand Corp. v. Sun Chem Corp.*, 553 F.2d 1033, 1045 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977).

In addition, because the SEC's claims in this matter relate to opinions of legal or contractual compliance, the SEC must meet the heightened standard of showing that "the speaker does not genuinely and reasonably believe them." *In re Donald Trump*, 7 F.3d at 368; *see also Boeing*, 711 F.3d at 759 (holding that plaintiffs must plead and prove that defendants made predictions knowing they were false in order to be actionable); *Indiana State Dist. Council of Laborers & Hod Carriers Pension & Welfare Fund v. Omnicare, Inc.*, 583 F.3d 935, 945-46 (6th Cir. 2009)(explaining actual knowledge of falsity of statement required to establish misrepresentation claim based on statement of legal compliance).

This is a high standard that is particularly hard to prove in connection with disclosures about compliance with ambiguous terms of a long, complex contract. Ms. Bebo's actions in connection with ALC's employee leasing do not show negligence much less the far higher standard of scienter.

A. Ms. Bebo's actions taken in implementing employee leasing were not consistent with any intent to deceive, manipulate or defraud.

The evidence does not show that Ms. Bebo implemented employee leasing under the Lease with any fraudulent intent. In fact, Ms. Bebo took all reasonable actions for an executive in her position when implementing the employee leasing practice in early 2009.

1. Ms. Bebo consulted with counsel.

Generally, consulting with legal counsel and involving legal counsel at every step of the process is inconsistent with the intent to deceive. Moreover, seeking and relying on the advice of counsel as to whether a contemplated course of action is legal can be a complete defense to the scienter element of a fraud claim. *United States v. Benson*, 941 F.2d 598, 614 (7th Cir. 1991) (tax case).

Here, Ms. Bebo consulted with Mr. Fonstad, ALC's general counsel. Mr. Fonstad was involved from the beginning of discussions on employee leasing in late 2008 and through each of the key steps in January and February 2009, including the call with Mr. Solari on January 20, the drafting of the e-mail sent to Mr. Solari on February 4, and at each step in the discussions related to the New Mexico properties. Thus Mr. Fonstad was aware of all the material facts and Ms. Bebo appropriately relied on Mr. Fonstad's legal advice as to compliance with the terms of the Lease.[63]

2. Ms. Bebo was aware the disclosure committee never urged different disclosures.

The Staff has not asserted, and there is no evidence to suggest, that anyone ever advised Ms. Bebo to disclose any of the information that the Staff alleges was omitted. In fact, ALC had a formal process created for the purpose of facilitating discussion of concerns or issues with the Company's financial statements or disclosures, including specifically the Company's disclosure committee. None of the scores of senior managers and other key accounting, finance and legal personnel involved in the process ever brought to Ms. Bebo's attention any issue with the disclosures regarding Ventas Lease compliance. Under these circumstances, it would be extremely difficult -- if not impossible -- for the Staff to prove scienter. *See, e.g., Durgin v. Mon*, 659 F. Supp. 2d 1240, 1256 (S.D. Fla. 2009) (plaintiff failed to adequately plead scienter where there were no allegations that "anyone advised Defendants or expressed concern to Defendants that the Company was engaging in fraud"); *SEC v. Coffman*, 2007 WL 2412808, at *14 (D. Colo. Aug. 21, 2007) (SEC failed to establish scienter where there was "no evidence that anyone suggested to [the defendant] that ... assets were impaired").

3. Ms. Bebo discussed ALC's plan with Ventas.

Ms. Bebo set up the January 20 call with Mr. Solari, an executive with the counterparty to the Lease, to confirm his understanding of the effect of employee leasing under the Lease. Ms. Bebo has a clear recollection of the matters discussed on this call, which covered all of the relevant features of the employee leasing practice as ALC would implement it, including having rooms available in the CaraVita Facilities for people who would have reason to go there and charging ALC regular market rates. Mr. Solari agreed that such employee leasing was permitted under the Lease and would count toward the occupancy and coverage ratios in the lease.

Mr. Solari was a high level Ventas executive and the principal relationship manager for the Ventas/ALC relationship. He had at least "apparent" authority to bind Ventas. Even if that were not true as a legal matter, ALC's reliance on Solari's authority was reasonable and certainly did not show any fraudulent intent or recklessness sufficient to support a Section 10(b) claim.

[63] The Company's controller, Mr. Levonowich, also testified that Mr. Fonstad participated in a meeting in the first quarter of 2009 - also attended by Ms. Bebo and Mr. Buono - where they discussed crediting the properties with rent revenue (i.e. intercompany revenue) attributable to employees using the facilities in lieu of hotels. (Levonowich testimony at 84-85.)

4. **Ms. Bebo sent a confirming e-mail to Ventas (which was reviewed by counsel) and Ventas did not object.**

Ms. Bebo tasked Messrs. Buono and Fonstad with preparing an e-mail to confirm the matters discussed during the January 20 call.[64] While the part of this e-mail addressing employee leasing was not as detailed as the discussion during the January 20 call, it was consistent with the employee leasing practice as ALC would implement it.

The e-mail was certainly clear enough to put Ventas on notice that ALC would implement employee leasing. In the e-mail, ALC stated that it was "confirming" its "notification" of employee leasing. From that language, it was clear that ALC was notifying Ventas of actual employee leasing rather than a proposal to further discuss the topic. From Ventas' perspective, it should not have mattered whether employees paid the rent to lease units or ALC paid the rent to make units available for employees. In either case, these units would not continue to be occupied at the end of the lease term or if Ventas otherwise took over operation of the properties. Regardless of the particular terms governing the periphery of the arrangement, Ventas knew that any employee lease would terminate with the conclusion of the ALC-Ventas relationship. If Ventas was really concerned about employee leasing, the January 20 conference call and February 4 e-mail were more than sufficient to raise questions.

Numerous Ventas executives with direct responsibility for the Lease received the e-mail, yet none of them asked any questions or raised any issues about it. Is it reasonable to believe that Ventas was meticulous and careful of details in managing its relationship with ALC and the CaraVita Facilities, yet somehow at least four Ventas senior executives and employees with responsibility for the lease relationship failed to notice and ask questions about the employee lease notification in the February 4 2009 e-mail? That strains credibility. The more reasonable explanation is that Mr. Solari had in fact agreed to employee leasing as Ms. Bebo recalls during the January 20 call and none of the other Ventas executives objected to it.

In any event, Ventas' own subjective interpretation of the e-mail, which indisputably was not provided to Ms. Bebo, is irrelevant. What is relevant is Ventas' words and actions conveyed to Ms. Bebo. Here, she saw that the e-mail went to Mr. Solari and three of Ventas' personnel responsible for the asset management of the business. It was certainly reasonable and proper for her (and for Mr. Fonstad, to whom Ms. Bebo forwarded the e-mail) to conclude that counting employees toward the covenants was agreeable to Ventas. From these facts, at most there was a misunderstanding between ALC and Ventas about the effect of employee leasing under the lease. Such a misunderstanding cannot form the basis of a violation of Section 10(b).

5. **Ms. Bebo consulted with ALC's board before implementing.**

Before implementing the employee leasing practice under the Lease, on February 23, 2009, Ms. Bebo and Mr. Buono consulted with Mr. Rhinelander, ALC's Vice Chairman of the Board and the person to whom Ms. Bebo normally reported. After Mr. Rhinelander consulted with David Hennigar, he told Ms. Bebo and Mr. Buono that they should implement employee leasing under the Lease. Ms. Bebo was also led to believe that the entire Board had endorsed the practice at that time. Following that approval, employee leasing was discussed at numerous Board or Audit Committee meetings, including in presentations by GT. The scope of employee leasing was also clear from the materials in packages

[64] It is undisputed that Ms. Bebo sent Mr. Fonstad a copy of the e-mail to Mr. Solari summarizing the call. She also sent him Ventas' response to the e-mail that day. Although Mr. Fonstad's recollection is selective and limited, Mr. Buono and Ms. Bebo recall that he was intimately involved in preparing the February 4 e-mail to Mr. Solari.

management provided to the Board on a quarterly basis. ALC Board members may claim that they were not aware of employee leasing before March 2012, but such a claim is contrary to the facts and in any event the information was there if they cared to listen during meetings or review Board materials. Ms. Bebo did not attempt to hide anything from the ALC Board regarding employee leasing.

6. Ms. Bebo understood that the finance department vetted the practice with ALC's auditor.

ALC informed GT of employee leasing in April or May of 2009 during its first quarterly review of a period including the employee leasing practice. Ms. Bebo spoke with Melissa Koeppel about employee leasing at that time and GT was provided with a copy of the February 4, 2009 Solari e-mail. During its quarterly reviews, GT had access to documents, including the list of employees, that clearly showed the scope of and procedures for employee leasing. Ms. Bebo is not aware of GT ever raising any issues with the practice.

7. Ms. Bebo relied on the finance department for the process and accounting determinations.

Ms. Bebo relied on Mr. Buono and his staff with respect to the accounting treatment of employee leasing, quarterly certifications to Ventas and regular communications with GT. Ms. Bebo is not an accountant, and was not in a position to question the accounting treatment of employee leasing, such as the effect of employee leasing on the coverage ratio calculations in the Lease under GAAP. Ms. Bebo recalls that she rarely, if ever, spoke with GT about employee leasing after her initial conversation with Melissa Koeppel in April or May of 2009. Ms. Bebo does not recall being directly involved in the Ventas compliance certification process at any time.

The first time that anyone at ALC raised concerns about the propriety of the employee leasing - in a hastily prepared "solicitor-client" memorandum by board member Alan Bell in April 2012 - Ms. Bebo brought those concerns directly to the audit engagement partner at GT for the auditor's consideration and input. Even then, GT raised no concerns about the employee leasing arrangement with Ms. Bebo.

These were not the actions of a person with any intent to deceive or defraud investors. Instead, these actions were entirely consistent with an executive reasonably and in good faith attempting to comply with the terms of a contract and support the conclusion that she genuinely and reasonably believed that ALC was in compliance with the Lease covenants.

8. The reasonableness of MS. Bebo's reliance on the propriety of the employee leasing practice is corroborated by the board's inaction upon learning of the Milbank findings.

In early May 2012, in response to a whistle-blower letter related to the employee leasing practice, the Company's audit committee retained Milbank, Tweed, Hadley & McCloy LLP to conduct a thorough internal investigation of that practice. The full extent and understanding of it was undoubtedly examined. Upon completion of the Milbank investigation, ALC stated in their Form 10-Q for the period ending September 30, 2012 that the investigation had been completed and ALC's "[b]oard has determined not to take any action."

The only inference from that statement is that Milbank concluded there was no impropriety in the practice. Indeed, had a different conclusion been reached, ALC would have clearly terminated CFO

John Buono. Likewise, at some point, ALC would have claimed, after the fact, that Bebo's termination (wrongful as she vigorously defended) was based in whole or in part on her participation in the employee leasing practice. To the contrary, ALC remained steadfast in its insistence that the propriety of the practice had nothing to do with the Board's decision to terminate her - at the time of the termination or any time subsequent. As Chip Roadman, the board member that replaced Ms. Bebo as CEO, testified in September 18, 2013:[65]

Q	Was the ALC -- ALC's leasing of units from Ventas, was that a reason for Ms. Bebo's termination?
A	No.
Q	Was there anything with respect to Ms. Bebo's handling of the Ventas lease that was a basis for her termination?
A	No. The reason for her termination was the mismanagement of the company with relationship to the regulators, the quality of care, and the reputation of the company.

B. ALC had viable alternatives to address covenant compliance if Ms. Bebo had not believed that employee leasing complied with the Lease.

Ms. Bebo's genuine belief that Mr. Solari, and the others at Ventas, had agreed to employee leasing on behalf of Ventas is shown by ALC's decision to implement employee leasing rather than other alternatives.

The terms of the Lease contained options to avoid defaulting under the occupancy covenant in the first part of 2009. Section 8.1.11(c) permitted ALC to remove from service up to 10% of the beds in each facility. Such an action would have removed those beds from the occupancy covenant count. Ms. Bebo, Mr. Buono and Mr. Fonstad were clearly aware of this provision at the time as it is mentioned in the February 4, 2009 Solari e-mail with reference to the hospice proposal. ALC also could have counted beds rather than units in determining occupancy, which would not have been inconsistent with the Lease. In fact, ALC was aware that the prior tenant had calculated occupancy based on beds rather than units without any objection from Ventas. Since a number of the units provided for double occupancy, counting people rather than units would have increased occupancy.

These two actions combined would have significantly improved ALC's ability to satisfy the occupancy covenant, and probably would have gotten ALC "over the hump" in early 2009, a theory the Staff has put forth as to the reason for starting the alleged "fraud" in early 2009. It does not matter whether such measures would have addressed occupancy covenant compliance for later periods during the term of the Lease. What is relevant, and probative of Ms. Bebo's state of mind in February 2009, was that none of these measures were explored at that time because Ms. Bebo reasonably believed she had an agreement with Ventas regarding employee leasing.

ALC also could have paid Ventas for a covenant waiver or purchased the CaraVita Facilities. Ventas was clearly willing to discuss covenant relief at the time as shown by the negotiation regarding the New Mexico properties. Ventas may not have been willing to provide all of the relief that ALC sought, but that was in the context of an ALC offer for the two Ventas New Mexico properties that did not meet Ventas' desired price. For the right price, Ventas surely would have considered greater covenant relief. That price likely would not have been very material to ALC, recognizing that the CaraVita Facilities were such a small part of ALC's business.

[65] Chip Roadman AAA/OSHA Testimony Transcript at 113.

A purchase of the CaraVita Facilities in early or mid-2009 was another option not explored by ALC because it had an understanding with Ventas. In fact, that is the course of action that ALC later took in 2012 after Ventas alleged that licensing issues at two of the properties constituted a default under the Lease. Ms. Bebo and Mr. Buono generally preferred the operational flexibility of owning properties, and freed from the constraints of the Lease could have implemented a number of profit enhancing measures at the CaraVita Facilities. While it is true that other ALC Board members, particularly Mr. Hennigar, resisted purchasing properties, it belies logic to suggest that ALC would have implemented a fraudulent employee leasing arrangement to accommodate the preferences of those Board members. The actual explanation is that ALC did not explore those alternatives because it had an agreement with Ventas for employee leasing.

C. Ms. Bebo's subsequent communications with Ventas were consistent with her belief in an agreement with Ventas on employee leasing.

In February 2009, after the January 20 call with Mr. Solari and the February 4 e-mail, Ms. Bebo believed that employee leasing under the Lease was settled and did not see any reason to raise the matter again with Ventas during the rest of 2009 or 2010.

The negotiations with Ventas during February 2009 regarding the potential purchase by ALC of two properties owned by Ventas in New Mexico were consistent with an agreement with Ventas on employee leasing. Ms. Bebo does not recall proposing relief with respect to the occupancy covenant in connection with those negotiations, and none is proposed in the written communications on the subject.

Ms. Bebo's February 19, 2009 e-mail to Mr. Solari containing ALC's covenant proposal did not request relief as to the occupancy covenant, but rather only as to the 12-month facility and portfolio coverage ratios. This made sense from ALC's perspective. Even with employee leasing in place, ALC would have wanted relief as to the coverage ratio covenants to provide ALC with more pricing flexibility at the CaraVita Facilities and to reduce management time and effort on tracking and certifying covenant compliance. The negotiations broke down over price. The negotiations do not show that Ventas viewed the covenants as very important, as the occupancy covenant was not addressed in the negotiations and Ventas was in fact willing to provide a limited waiver of one of the coverage ratio covenants in connection with a proposed price that was less than Ventas ended up receiving from a third party. From Ventas' perspective it made more sense not to waive the covenants (particularly the coverage ratio covenants) and seek a better price for the New Mexico properties.

In fact, there are reasons to conclude that the occupancy and coverage ratio covenants were not very important to Ventas. Ms. Bebo certainly received the impression from Mr. Solari that Ventas was more concerned with continuing to receive lease payments for the six years remaining on the Lease. Ventas was protected by the ALC corporate guarantee, so that the payment obligations were covered by an ALC business with more than 200 properties in addition to the 8 CaraVita Facilities leased from Ventas. Mr. Solari confirmed in interviews and testimony that he was not personally concerned with ALC's potential breach of the covenants in late 2008 or early 2009 because ALC had sufficient liquidity and capital resources to assure Ventas' revenue stream was secure.

The limited importance of occupancy covenants to Ventas is further supported by its statements in two publicly filed responses to SEC comment letters. First, in 2010 the SEC requested that Ventas provide occupancy data for all of its properties, including the triple-net leased properties of which the CaraVita Facilities comprised a small number. In response, Ventas contrasted the buildings which it owned and operated under contract with Sunrise, where "occupancy levels have a direct impact on our net operating income," with the triple-net lease facilities where it stated that "while occupancy

information is relevant to the operations and financial results of the tenant, [Ventas'] revenues and financial results are not directly impacted by occupancy levels at the properties."[66]

Similarly, in a May 24, 2012 letter from Ventas to the SEC staff responding to another comment letter, Ventas reiterated its prior statement and went further, stating "neither rates nor occupancy levels directly affect the [Ventas'] financial results." In addition, Ventas recognized that the data provided by tenants like ALC could be inaccurate: "While [Ventas] has no reason to believe that the information it receives from its third party operators is inaccurate in any material respect, the Company cannot and does not verify this information either through an independent investigation or otherwise."[67] And Ventas noted that many of its tenants are not public companies that have to provide accurate information to the SEC and also may not provide occupancy information to Ventas "on a timely basis or at all."

As a competitor to ALC, Ventas had a history of seeking information from ALC regarding market conditions. In communicating with Ventas about occupancy statistics during quarterly calls and other communications, it never occurred to Ms. Bebo to address employee leasing rather than the types of marketing developments that ALC would normally address. These communications do not in any way cast doubt on the agreement regarding employee leasing that ALC and Ventas reached in early 2009. Ms. Bebo viewed employee leasing under the Lease as settled and there was no reason to address the point again with Ventas.

D. Other evidence does not show that Ms. Bebo acted with an intent to defraud investors.

Staff has taken testimony from witnesses who indicated they had concerns about the legitimacy of the employee leasing practice. There are issues with these potential witnesses that undercut their credibility and relevance.

1. Lower-level finance department employees.

Two of the members of the accounting staff whose responsibilities involved the employee leasing arrangement, Robin Herbner and Sean Schelfout, have each told the SEC staff that they believed the arrangement was wrong or improper. There are two principal issues with these persons as potential witnesses. First, they lack personal knowledge of the steps taken by Ms. Bebo and ALC before starting the employee leasing arrangement. Neither of them participated in the January 20, 2009 call with Mr. Solari, and so they did not really know the scope of what Mr. Solari had agreed to. We do not believe that either of them consulted with Mr. Fonstad or any other ALC counsel on the matter, or understood the relevant terms of the Lease.

Second, their statements today are contradicted by their actions at the time. Neither employee raised any objection about the practice to Ms. Bebo; nor did they express it as a reason for them leaving the company to Ms. Bebo. Mr. Hokeness and other similarly testified that they did not indicate that discomfort with the employee leasing was the reason they left ALC. We understand that Ms. Herbner left ALC shortly after she returned from maternity leave in late 2009. She had expressed concerns about the amount of travel involved with her position once she had a young child. She ended up taking a position at another large company with higher compensation and limited travel. Even then, before

[66] August 3, 2010 Ventas letter to the SEC (emphasis added), available at: https://www.sec.gov/Archives/edgar/data/740260/000095012310071826/filename1.htm

[67] May 24, 2012 Ventas letter to the SEC (emphasis added), available at: https://www.sec.gov/Archives/edgar/data/740260/000110465912039693/filename1.htm

leaving ALC to take that position, she approached Ms. Bebo to see if ALC could match the higher compensation she had been offered and require less travel. Similarly, when Mr. Schelfout received an offer from another employer that would pay him more than he earned at ALC, he first approached ALC about matching or exceeding the offer he received before taking it. This is inconsistent with someone leaving ALC due to concerns about employee leasing.

Third, we understand that neither Ms. Herbner nor Mr. Schelfout registered complaints through ALC's confidential whistleblower procedures ALC had in place during the entire period, or reported concerns to the internal or external auditor, audit committee, or counsel even after they left ALC.

And when Dan Grochowski stated that he would prefer not to continue being involved in the Ventas reporting because he had not been involved in the discussions with Ventas regarding employee leasing or had an opportunity to discuss the practice with Mr. Fonstad while he was still with ALC, Mr. Grochowski did not raise any concerns or issues with Ms. Bebo regarding the propriety of the employee leasing arrangement. Neither Ms. Bebo nor Mr. Buono took any adverse employment action against Mr. Grochowski, and they agreed that he did not have to perform any functions with respect to covenant reporting to Ventas.

2. Mr. Buono and Mr. Solari.

Mr. Buono's recollection about the implementation of employee leasing in 2009 seems to be less complete. However, his testimony in many key respects corroborates Ms. Bebo's testimony, and it otherwise is not clear that he contradicts any of the significant facts that Ms. Bebo recalls or simply does not remember them.

In any event, Mr. Buono's actions throughout the period support Ms. Bebo's statements. Mr. Buono set up the process to implement employee leasing, including the employee lists, consistent with the terms discussed during the January 20, 2009 call with Mr. Solari. Mr. Buono set up the "997" account and the accounting treatment of the arrangement. Mr. Buono directly oversaw the interaction with GT regarding the auditor's procedures to review the arrangement. Mr. Buono handled the quarterly certifications to Ventas. Aside from adding names to the lists, he oversaw these matters with almost no direct involvement by Ms. Bebo.

Mr. Buono and Mr. Fonstad also addressed the employee leasing arrangement at meetings of ALC's disclosure committee in throughout 2009, which was referenced in the minutes for the meetings. Ms. Bebo was not present, as she was not a member of the disclosure committee.

Mr. Buono repeatedly and steadfastly affirmed his belief in the appropriateness of the employee leasing practice. For example, even after Mr. Bell had questioned employee leasing in his April 3, 2012 memorandum and the ALC Board had launched an internal investigation on May 3, 2012, Mr. Buono signed a representation letter to GT on May 15, 2012 stating that "[m]anagement believes that [the Ventas covenant compliance] certificates were appropriate under the terms of the lease."

As the only person from Ventas on the January 20, 2009 call, Mr. Solari has confirmed that he does not recall any details about it. Thus, he is not able to dispute Ms. Bebo's recollection of the content of the conversation. Whether he or others at Ventas "would have" agreed to the employee leasing arrangement as discussed in the telephone conversation or as set forth in the February 4, 2009 e-mail is irrelevant and would be inadmissible in any proceeding.

Moreover, Ventas' apparent assertion that they would not have even permitted employees to stay at the properties and pay rent is not credible - in sum, the contention is that they "would not have" permitted employee leasing in any form. But this is contradicted by the February 4, 2009 e-mail itself. The e-mail clearly stated that ALC would implement employee leasing in some form. It was received by at least four Ventas executives with responsibility for the lease relationship with ALC, yet none of them objected or raised any questions. Even giving Ventas the benefit of the doubt in this area (despite the fact that the SEC would have the burden to prove fraud), at most there was a misunderstanding between ALC and Ventas about the effect of employee leasing under the Lease. Such a misunderstanding cannot form the basis of a violation of Section 10(b).

E. Ms. Bebo had no personal financial interest in committing fraud.

One way to establish scienter is to demonstrate that the defendant received a personal substantial benefit from the fraud. *See, e.g. Plumbers and Pipefitters Local Union 719 Pension Fund v. Zimmer Holdings, Inc.*, 679 F.3d 952, 956 (7th Cir. 2012). Conversely, where there is a lack of any personal benefit from the alleged fraud, it undermines an inference of scienter. *Id.* As the Seventh Circuit stated in dismissing a private securities complaint in *Zimmer*:

> If, as plaintiffs maintain, [defendants] told a series of lies during the first half of 2008 about ... one product that together produced less than 10% of the firm's income ... and affected earnings by only 15¢ a share, they were putting their fortunes and careers at stake in exchange for very little in return. This aspect of plaintiffs' arguments thus undermines, rather than strengthens, the inference of scienter.

Id.

In this case, Ms. Bebo also had no personal financial interest in devising a fraudulent employee leasing arrangement. In fact, she received no direct personal benefit from the employee leasing arrangement at all. Even if a default under the Lease could have adversely affected the ALC stock price (it did not), Ms. Bebo owned few shares of ALC stock and did not sell any shares while the employee leasing arrangement was in effect. ALC's proxy statement for its 2009 annual meeting reported that Ms. Bebo beneficially owned only 18,653 shares of Class A Common Stock as of March 20, 2009.

She also held unearned stock options covering up to 20,000 shares at that time with an exercise price of $29.45 per share. Moreover, the options were granted based on targets for private-pay occupancy at ALC facilities, as reported in the company's public filings. It is undisputed that the employee leasing arrangement had no impact on the publicly reported occupancy data.

Ms. Bebo's annual performance compensation also would not have been affected by a covenant compliance issue under the Lease. Payments under ALC's cash incentive compensation program were determined based on Adjusted EBITDAR and Adjusted EBITDAR margin, which excluded transaction costs and non-cash, non-recurring gains and losses such as impairment of goodwill or other long-lived assets. This measurement would have excluded one-time costs related to a purchase, buy-out or other expenses relating to the resolution of a default under the Lease.

Finally, just as in *Zimmer*, the CaraVita Facilities were also an immaterial part of ALC's business, constituting less than 6% of ALC's revenue and 2.1% of ALC's operating income for the year ended 2011. An issue relating to the Lease would not have affected ALC's operations or Ms. Bebo's compensation enough to provide an incentive to commit fraud.

PART II: THERE IS NO BASIS FOR NON-FRAUD OR AIDING/ABETTING CLAIMS AGAINST MS. BEBO

I. There Is No Basis for a Claim Against Ms. Bebo Under Section 13(a) of the Exchange Act.

The Staff has also indicated that it is considering recommending claims against Ms. Bebo based on allegations she directly violated Section 13(a) of the Exchange Act thereunder, and that she aided and abetted or caused ALC to violate Section 13(a) and Rules 12b-20, 13a-1 and 13a-13. To establish violations of these provisions, the SEC must show that ALC's public filings contained material misstatements or omissions. In addition, the Staff alleges Ms. Bebo submitted false Sarbanes-Oxley certifications in violation of Rule 13a-14 because the public filings she certified contained false or misleading statements. These claims fail for three independent reasons.

First, as demonstrated above there is no basis to conclude that ALC's public filings contained any material misstatements or omissions. Because the Staff's asserted claims under Section 13 are based on the same allegations of falsity, the Section 13(a) claim and related claim of false certifications would fail for the same reasons. *See, e.g., SEC v. Cedric Kushner Promos., Inc.*, 417 F.Supp.2d 326, 336-37 (S.D.N.Y. 2006).

Second, a violation of Rule 13a-14 does not give rise to an independent cause of action. As one court has found in the context of private securities litigation, "there is nothing in either the [Exchange Act] or the Sarbanes-Oxley Act and implementing regulations that authorizes plaintiffs to base a claim for securities fraud on an alleged misstatement in a Sarbanes-Oxley certification." *In re Silicon Storage Tech. Servc. Litig.*, 2007 WL 760535, at *17 (N.D. Cal. Mar. 9, 2009). Rather, courts have found that Sox certifications themselves are <u>not</u> actionable. *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).

The rule is the same when an action is brought by the SEC. *See SEC v. Black*, 2008 WL 4394891, at *17 (N.D. Ill. Sept. 24, 2008).[68] In *Black*, the Commission attempted to persuade the court to create an exception for Sarbanes-Oxley certification claims in cases brought by the SEC, but the court flatly rejected such a special rule. *Id.* at *16-17. The court pointed out that the cases cited by the SEC, in which claims brought under Rule 13a-14 were allowed to proceed, dealt only with the sufficiency of factual allegations in a complaint and did not address "whether a false certification can stand as an independent claim." *Id.* at *16 (citations omitted). Thus, the court held, "[c]onsistent with the SEC Release and the two cases that have addressed the issue [i.e., *Silicon Storage* and *Intelligroup*] ... a false Sarbanes-Oxley certification does not state an independent violation of the securities law."[69] *Id.* at *17.

---

[68] Other courts outside of the Seventh Circuit have concluded that there is an independent cause of action under Rule 13a-14. *See SEC v. Brown*, 740 F. Supp. 2d 148, 164-65 (D.D.C. 2010).

[69] The SEC Release upon which the *Black* court relied, states:

> An issuer's principal executive and financial officers <u>already</u> are responsible as signatories for the issuer's disclosures under the Exchange Act liability provisions and can be liable for material misstatements or omissions under general antifraud standards and under our authority to seek redress against those who cause or aid or abet securities law violations. An officer providing a false certification potentially could be subject to Commission action for violating Section 13(a) or 15(d) of the Exchange Act and to both Commission and private actions for violating Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5.

Certification of Disclosure in Companies' Quarterly and Annual Reports, SEC Release No. 8124, 2002 WL 31720215, at *9 (Aug. 28, 2002) (emphasis added).

Third, an aiding and abetting claim requires the establishment of three elements: (1) a primary violation of the Exchange Act, (2) actual knowledge of the violation by the aider and abettor, and (3) that the aider and abettor substantially assisted the primary violation. *SEC v. Espuelas*, 905 F. Supp. 2d 507, 517 (S.D.N.Y. 2012). As noted in the first point, above, the SEC will not be able to establish a primary violation. In addition, the SEC will not be able to establish actual knowledge of the violation by Ms. Bebo, the alleged aider and abettor. This is because, as set forth in Part I, Section IV *supra*, Ms. Bebo acted with the honest and reasonable belief that ALC was appropriately complying with the Lease covenants based on the understanding with Ventas related to employee leasing.

II. There Is No Basis for a Books and Records or Internal Controls Claim Against Ms. Bebo.

The Staff alleges that Ms. Bebo directly violated Section 13(b)(5) of the Exchange Act and Rule 13b2-1 promulgated thereunder, and that she aided and abetted or caused ALC to violate Section 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act. As a general matter, these provisions provide for liability where a defendant knowingly falsifies company accounting records, causing the company's records to not fairly reflect its transactions, or circumvents internal accounting controls. Staff has not made clear the basis for the allegations under these provisions, but they appear to relate in some way to the lists of employees that supported the covenant calculations under the Lease.

A. The Lists Do Not Constitute A Book Or Record Under Section 13(b)(2)(A) And Were Not False.

Section 13(b)(2)(A) requires every issuer to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." Rule 13b2-1 prohibits falsifying a record that qualifies under this section.

The clear intent of this provision is to assure that the financial statements contained in filings with the Commission are true and correct. *See Promotion of the Reliability of Financial Information and the Prevention of the Concealment of Questionable or Illegal Corporate Payments and Practices,* Federal Register, Vol. 44, No. 36 at 10964 (Feb. 23, 1979) (stating "The [new] rules are designed to promote the reliability and completeness of the financial information that issuers are required to file with the Commission, or disseminate to investors, pursuant to the Securities Exchange Act...").[70] In this instance, there is no question that the employee leasing practice had no effect whatsoever on the Company's financial statements reported to the Commission; the integrity of the Company's financials is not an issue. Moreover, none of the lists that Ms. Bebo was involved with preparing in relation to employee leasing constitute records that "reflect the transactions and dispositions of assets" of ALC. They simply reflected days that employees and other non-residents affiliated with ALC stayed or had reason to stay at any of the CaraVita Facilities for purposes of calculating covenants under the Lease - a far different purpose than the focus of Section 13(b) which is on ALC's reported financial statements.

Moreover, nothing about the lists were false in any material way. First, it would be self-evident to anyone receiving the lists, including ALC's auditors, that the lists were not meant to reflect actual employee stays. No one reviewing the lists could conclude otherwise, given the number of employees listed at multiple facilities for entire months at the same time. Nor does the inclusion of contractors or family members on the lists render them false, given that they met the criteria based on Ms. Bebo's

[70] The SEC's adopting release also states the following with respect to the scope of the Rule: "This provision is designed, not only to provide a more reliable basis for the preparation of financial statements, but also, among other things, for the purpose of confirming the Commission's authority 'effectively to prevent off-the-books slush funds' and to assure that 'there is proper accounting of the *use* of corporate funds...." *Id.* at 10966.

discussion with Mr. Solari. Finally, Staff has contended that there were a few employees on the lists that were no longer employed by ALC, yet were included. But Section 13(b) is not a strict liability statute, converting any misstatement, no matter how small, into a securities law violation. *See SEC v. Todd,* 642 F.3d 1207, 1219 (9th Cir. 2011) (stating "[t]he SEC acknowledges that the rule does not create a 'strict liability' scheme"); *Espuelas*, 905 F. Supp. 2d at 525-26 (violation requires unreasonable conduct; not strict liability).[71]

B. There Is No Support for a Claim of Failure to Implement or Conduct Circumventing "Internal Accounting Controls."

Section 13(b)(2)(B) requires every issuer to "devise and maintain a system of internal accounting controls" for several limited purposes: (1) to make sure transactions are executed in accordance with management's general or specific authorization; (2) to assure transactions are recorded as necessary to permit preparation of financial statements that conform to GAAP; (3) to maintain accountability for assets; (4) to assure that access to assets is permitted only in accordance with management's authorization; and (5) to assure recorded assets reasonably equals existing assets.

Simply put, nothing related to the employee leasing practice that ALC utilized for meeting the Ventas Lease covenants had anything to do with the internal control issues identified in the statute. As with the books and records provision, the clear intent of the statute is to assure that the financial statements reported to the Commission conform to GAAP and that the transactions that are reflected in the financial statements are sufficiently accurate that reasonable assurance can be provided that all assets and liabilities on those financial statements are accurate. Here employee leasing was performed in accordance with management's instructions, there is no dispute that ALC's financial statements were GAAP compliant, and that all assets of the Company were reported in its financial statements appropriately. Consequently, there can be no violation of Section 13(b)(2)(B) or Rule 13b2-1.

C. The Commission Cannot Establish the Requisite Mental State.

Section 13(b)(5) of the Exchange Act provides that "[n]o person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account." 15 U.S.C. § 78m(b)(5). Given the plain language of the statute, which requires that the conduct be done "knowingly," Section 13(b)(5) requires the SEC to plead and prove scienter. *See S.E.C. v. Retail Pro, Inc.*, 2010 WL 1444993, *3-4 (S.D. Cal. Apr. 9, 2010). And although most courts have found that Rule 13b2-1 does not require a showing of intent to deceive, it does require that the defendant acted unreasonably. Courts have equated unreasonableness with reckless conduct. *Espuelas*, 905 F. Supp. 2d at 525-26. For the reasons previously stated, Ms. Bebo did not act with scienter or recklessly with respect to the employee leasing practice.

III. There Is No Basis for a Rule 13b2-2 Claim for Misleading the Company's Auditors.

Rule 13b2-2, which prohibits making materially false or misleading statements or omissions to a company's auditors in connection with an audit or review of the company's financial statements or SEC filings. As with the other Section 13(b) claims, Staff has not made clear what it specifically believes

---

[71] *See also* the SEC's adopting release, which notes that Section 13(b)(2)(A) requires the books and records of a company to "*in reasonable detail*, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." Congress inserted the "reasonable detail" language because "the provisions, 'if unqualified, might connote a degree of exactitude and precision which is unrealistic.'" 44 Federal Register No. 38 at 109688.

Ms. Bebo did wrong in her dealings with the Company's auditors, GT. In any event, a Rule 13b2-2 claim would fail for similar reasons.

First, Ms. Bebo did not make any materially false or misleading statement to the auditors. Indeed, based on her testimony, she had minimal direct interaction with the auditors in relation to the employee leasing and Lease covenants. She recalled one specific conversation with Melissa Koeppel very early in the process in which the general parameters of the employee leasing practice were discussed. After that, Ms. Bebo relied on Mr. Buono and his staff to prepare the necessary documentation and journal entries necessary to implement the practice and to coordinate GT's review of it. GT's own internal notes (referred to by Staff during Mr. Schelfout's testimony) would indicate that GT had a robust understanding of the practice. They indicate that the employee adjustment to financial statement occupancy relates to extra rooms at each facility not currently occupied by ALC residents, and that rooms are paid for by ALC to improve the overall performance of each facility.

Nor can a claim under Rule 13b2-2 be premised upon the lists that were being provided to GT. For example, the lists are clear on their face that they are not meant to capture actual employee and other non-resident stays at the CaraVita facilities. As Staff has pointed out, a number of employees were included for entire quarters at multiple facilities. Consequently, it is clear that GT knew the lists did not identify actual stays by employees, but identified those employees that had reason to stay at a facility during the quarter.

Nor can a Rule 13b2-2 violation be premised on those few instances where employees on the lists that were no longer employed by ALC or because GT claims it did know the identity of some of the employee family members that were on the list. This is because the Rule requires the statement to be *materially* false or misleading. Given the small number of instances and the fact that these were or could have been easily checked by GT, it was simply immaterial as a matter of law.[72]

Second, to the extent that there were a few employees on the lists that were no longer employed by ALC, Ms. Bebo reasonably believed that both her internal accounting staff and GT had implemented procedures to identify such anomalies. Indeed, both GT and staff had identified certain employees that should be removed from the lists at various times. Third, family members

Finally, a claim under Rule 13b2-2 requires a showing of scienter, such as intent to deceive or recklessness. *See SEC v. Todd,* 642 F.3d 1207, 1220 (9th Cir. 2011); *Espuelas*, 905 F. Supp. 2d at 525-26. There is absolutely nothing in the record that has been made available to us that would indicate that Ms. Bebo intended to make false or misleading statements to GT in connection with its review of the employee leasing practice.

PART III: PRACTICAL AND POLICY CONSIDERATIONS MILITATE AGAINST A FRAUD ACTION

As noted at the outset of this Wells submission, a decision in favor of bringing charges under the facts of this case has important implications for issuers, and their officers and directors. In expressing an opinion about legal compliance with a contract, issuers and their management are making a host of

---

[72] Ms. Bebo reasonably believed that both her internal accounting staff and GT had implemented procedures to identify such anomalies. Indeed, both GT and staff had identified certain employees that should be removed from the lists at various times. In addition, several of the GT audit staff met Ms. Bebo's mother at ALC's annual meetings, where she would have been introduced as Gail Peremski - the name her mother used in her capacity as an employee with ALC and the name that appeared on the lists.

judgment calls about the meaning of the contract, about how performance under the contract fits within the potential different interpretations of the contract, and ultimately about the potential interpretations, perceptions and future actions of their contractual counterparty.

Where the contract is unclear - as they often are in complex business transactions - management is faced with an unpalatable dilemma. On the one hand, management can obtain complete clarity of the issues from their contractual counter-party. In this way, they can be assured that their statement of legal compliance with a contract will not be second-guessed later in an SEC enforcement action. However, this may not be what is best for the company to which they owe fiduciary duties. The company may best be served by taking an aggressive, although eminently defensible position, with respect to the contract even at the expense of the counter-party. If management chooses this course of action, they risk being exposed to personal liability under the various fraud and non-fraud provisions alleged by the Staff in this case if a dispute between the two parties to the contract later materializes.

Thus, management is placed in an untenable position of having to choose between protecting their personal interests in avoiding later charges brought by the SEC and what management honestly and reasonably believes may be the best course of action for the company and its shareholders.[73]

The end result of enforcement actions in this type of case will have two distinct effects. First, it will result in companies and their management limiting discussion and disclosures with respect to legal and regulatory compliance or, at the other end of the spectrum, swamp shareholders in information. Neither outcome serves the investing public.

An enforcement regime that penalizes errors of management opinions and beliefs about complex factual and legal determinations will necessarily lead to more limited disclosure on these topics or silence, without any significant benefit to investors. Because under Section 10(b) there is no categorical "affirmative duty to disclose" even "material information," "companies can control what they have to disclose ... by controlling what they say to the market." *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1321-22 (2011). Given the potential for significant consequences based on nothing more than their genuinely expressed beliefs about the legal compliance of a company, adopting the Staff's approach in this case would inevitably chill such disclosures.

Alternatively, as the U.S. Supreme Court has recognized, "management's fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information -- a result that is hardly conducive to informed decisionmaking." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 448-49 (1976).

The Chair of the Commission, Mary Jo White, has echoed this statement recently in a speech, stating:

> When disclosure gets to be 'too much' or strays from its core purpose, it could lead to what some have called 'information overload' - a phenomenon in which ever increasing amounts of disclosure make it difficult for an investor to wade through the volume of information she receives to ferret out the information that is most relevant.

10/15/2013 Speech before the National Association of Corporate Directors - Leadership Conference.

---

[73] Indeed, the Commission's proposed application of the statute under the circumstances fails to give her and others similarly situated sufficient notice of what conduct could constitute a violation, thus making that application potentially unconstitutional. *See F.C.C. v. Fox Television Stations, Inc.*, 132 S. Ct. 2307, 2317 (2012) (agency application of regulation that does not give adequate notice of proscribed conduct struck as unconstitutionally vague).

The second consequence of the Staff's approach is that it will encourage companies and their management to litigate contractual disputes (and disputes with regulators) to the bitter end in order to avoid a subsequent securities enforcement charges stemming from a settlement of alleged breaches of a material contract. This would undermine the longstanding judicial policy of encouraging resolution of disputes. And this case amply illustrates this problem. In support of the contention that ALC's legal compliance statements were false, the Staff has placed great weight on the resolution of the Ventas lawsuit through a purchase of the buildings, which it surmises was at an inflated price. It has also relied extensively on the testimony witnesses from ALC's litigation opponent, Ventas, who, although they admittedly never complained or responded to the written disclosure of ALC's confirmation of its intent to satisfy Lease covenants through rentals related to employees, expressed righteous indignation that the practice ever occurred.

CONCLUSION

For the reasons set forth herein, we respectfully submit that the Commission should not bring any charges for alleged securities violations against Ms. Bebo. In closing, we note this submission does not purport to be a complete or otherwise comprehensive defense against the Staff's contemplated claims against Ms. Bebo, due in part to the page limitations imposed (Ms. Bebo appreciates the five page expansion granted in response to her request to have a 20 page extension). Moreover, access to known and previously described notes and documents within predecessor ALC's possession (i.e. prior to the sale that took the Company private) have not been provided to Ms. Bebo by either the Company or the SEC, and there are of course a host of unknown and unproduced documents. Finally, we have concerns about spoliation of evidence by the predecessor ALC which may affect her ability to defend the matter.

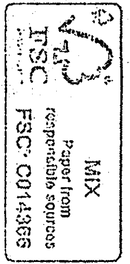
Dated: August 1, 2014

Respectfully submitted,

/s/

Mark A. Cameli
mcameli@reinhartlaw.com
Ryan S. Stippich
rstippich@reinhartlaw.com
Reinhart Boerner Van Deuren s.c.
1000 North Water Street, Suite 1700
Milwaukee, WI 53202
Telephone: 414-298-1000
Facsimile: 414-298-8097

20115712



FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LAURIE A. BEBO PURSUANT TO 17 CFR § 200.83

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the matter of:

Assisted Living Concepts, Inc. No. C-7948

SUPPLEMENTAL WELLS SUBMISSION ON BEHALF OF LAURIE A. BEBO

Mark A. Cameli
mcameli@reinhartlaw.com
Ryan S. Stippich
rstippich@reinhartlaw.com
Reinhart Boerner Van Deuren s.c.
1000 North Water Street, Suite 1700
Milwaukee, WI 53202
Telephone: 414-298-1000
Facsimile: 414-298-8097

Dated: September 26, 2014

INTRODUCTION

On behalf of Laurie A. Bebo, we submit this supplemental Wells submission as an additional response to the letter dated June 12, 2014, whereby the Chicago Regional Office of the Division of Enforcement Staff (the "Staff") of the United States Securities and Exchange Commission (the "Commission" or "SEC") informed counsel that it intended to recommend that the Commission bring a civil enforcement action against her for various alleged violations of the federal securities laws.

Since the time of Ms. Bebo's August 1, 2014 Wells submission, we were provided the opportunity to review additional testimony transcripts that had not yet been prepared and/or were otherwise not available to Ms. Bebo's counsel prior to that time.[1]

We submit this brief supplemental Wells submission because, in our view, this new testimony amplifies many of the key points made in the initial submission.

I. ALC's V.P. Of Sales And Marketing Corroborates Key Aspects Of Ms. Bebo's Testimony With Respect To The January 20, 2009 Telephone Conference With Joe Solari.

In Ms. Bebo's Wells submission, we described the evidence related to an important January 20, 2009 telephone conference with Joe Solari from Ventas, in which Ms. Bebo, Mr. Buono, Mr. Fonstad also participated. In 2009, Kathy Bucholtz was ALC's Vice President of Sales and Marketing. In her testimony, she described how she was present in Ms. Bebo's office at the time the call with Mr. Solari began, at which point she left.

Several important details of that telephone conference were corroborated by Ms. Bucholtz in her testimony. For example, like Ms. Bebo and Mr. Buono, she recalls that Eric Fonstad was present for the call with Mr. Solari, although she could not be positive.

In addition, she testified that soon after the call Ms. Bebo and/or Mr. Buono informed Ms. Bucholtz that Mr. Solari had just "approved counting employees in occupancy." (Kathy Bucholtz Testimony Transcript at 55.)[2] She also recalls Ms. Bebo or Mr. Buono discussing the fact that Mr. Solari had agreed that the rooms could be rented and paid for by ALC rather than the employees:

Q	[D]id either Mr. Buono or Ms. Bebo give you any more detail on what Ventas, or what Mr. Solari had agreed to, other than including employees in the occupancy determinations?
A	I believe they said that we were able to lease apartments back to ourselves for employees to stay. And--
Q	Is there anything else that either Mr. Buono or Ms. Bebo told you after that call with Mr. Solari about what Mr. Solari had agreed to?

[1] As with transcripts that were previously made available, Ms. Bebo's counsel does not have possession of copies of the transcripts and had limited time to summarize and digest the transcripts. Despite those constraints, we believe that the discussion of or quotations from the testimony transcripts are materially accurate given the circumstances.

[2] *See also* Kathy Buchholtz Testimony Transcript at 56:

> Q: Joe Solari had agreed that ALC could include employees in its occupancy determinations for the CaraVita properties?
>
> A: Correct

A	No. Not that I remember.

(Kathy Bucholtz Testimony Transcript at 61-62.)

II. ALC's V.P. of Sales and Marketing Understood Ms. Bebo Obtained Direction From The ALC Board Prior To Fully Implementing Employee Leasing.

As set forth in Ms. Bebo's Wells submission, the Commission will be unable to demonstrate scienter because, among other things, Ms. Bebo was transparent about the employee leasing practice with ALC's general counsel, auditors, and board of directors, among others.

Ms. Bucholtz's testimony corroborates the fact that Ms. Bebo sought and obtained instruction from the board of directors before fully implementing the employee leasing arrangement. Consistent with Ms. Bebo's recollection, Ms. Bucholtz recalled that after the Joe Solari telephone conversation, ALC began to track actual stays by employees at the CaraVita Facilities because the board of directors had not yet approved the practice. Following board instruction on the matter, employees did not have to try and track actual stays at the facilities.[3] Based on contemporaneous discussions with Ms. Bebo or Mr. Buono (she did not typically attend board meetings), Ms. Bucholtz testified, "I know that our board of directors also had to approve this process."[4]

III. Board Members' Denial Of Ms. Bebo's Transparency With The Board About Employee Leasing Is Not Credible.

We were provided the opportunity to review testimony provided by the following members of ALC's board of directors: Chairman David Hennigar, Vice Chairman Mel Rhinelander, Chair of the Audit Committee Malen Ng, and Alan Bell.

A. ALC's Audit Committee Chair Confirms Employee Leasing Was Discussed In Detail At A May 2011 Audit Committee/Board Meeting.

Ms. Ng acknowledged that the utilization of employees to meet Ventas Lease covenants was discussed at a meeting of the Audit Committee in May of 2011, unlike Messrs. Hennigar, Rhinelander, and Bell, who appear to contend that employee leasing matters were never discussed at the board level prior to March 2012.[5]

Ms. Ng testified that it "registered" with her that ALC was leasing units for employees in May 2011 during her pre-audit committee conference call with the company's auditors, Grant Thornton, relating to the review of the first quarter financials.[6] The Grant Thornton audit partner, Jeff Robinson,

---

[3] *Id.* at 57, 59-60.

[4] *Id.* at 60.

[5] Mr. Rhinelander was equivocal about whether employee leasing at the CaraVita Facilities had been discussed at the board level prior to March 2012. He testified that he thought it had been discussed in some capacity at an audit committee meeting in the Fall of 2011. He recalled another director, Derek Buntain make a comment along the lines of "why don't we just fill the facilities up with all our employees." (Mel Rhinelander Testimony Transcript at 43.) The lack of additional discussion about Mr. Buntain's "joke" provides a strong inference that this was not the first time employee leasing had come before the board. This would be consistent with Ms. Bebo's (and others') testimony.

[6] Ms. Ng has a vague recollection that employee leasing was discussed at an earlier meeting, but she could not be more specific. (Malen Ng Testimony Transcript at 51-52.

discussed how ALC was leasing units for employees' use.[7] He explained how revenue from ALC corporate was flowing onto the facility financials and then eliminated through consolidation. Thus, the inter-company revenue was netted out and financials reported to investors were not affected.

Importantly, Ms. Ng understood at this time that the intercompany revenue and the units leased by ALC were being counted toward the Ventas covenant calculations:

Q	Did you have a personal understanding or a belief about whether the ALC employees leasing units at the CaraVita facilities were included in the covenant calculations?
A	I have assumed that if they are included in the occupancy, that they will enter into the covenant calculation.

(Malen Ng Testimony Transcript at 41.)

Ms. Ng then testified about a discussion she had with Mr. Buono following her call with the auditors. They discussed the employee leasing practice, and Mr. Buono indicated it was not something new and something that the previous operator had done. He also informed Ms. Ng that Ms. Bebo discussed the practice with Ventas and there was written confirmation of that discussion.[8]

Finally, she testified how the Grant Thornton audit partner made a presentation to the audit committee of the board of directors, which was attended by all board members, at the May 2011 meeting. Ms. Ng's testimony is highly consistent with Ms. Bebo's own testimony about Grant Thornton's presentation to the board, which she testified occurred at the same meeting, Mr. Robinson's first as head audit partner on the account.[9]

During that meeting, the Grant Thornton audit partner made a presentation similar to what he told Ms. Ng over the phone earlier. Among other things, she recalls him discussing how ALC accounted for the intercompany revenue so that it was netted out and did not affect the financial statements reported to the SEC and investors.

Given that the auditors described the accounting treatment of employee leasing, board members were indisputably aware by at least May of 2011 -- though the totality of the evidence supports the conclusion they were aware of and approved the practice at the outset -- that ALC was recording revenue on the facility financial statements due to units leased at the facilities by ALC corporate, and that a debit was entered on the financial statements so that reported financials would not be affected by the intercompany transfers. Based on Ms. Ng's testimony, no reasonable trier of fact would conclude that the board did not know the size of the practice by this time as well -- it seems inconceivable that Grant Thornton would make a presentation regarding the accounting treatment without discussing how large the journal entries reflecting the intercompany revenue were.[10] Ms. Bebo recalls that the scope of the practice was one of the key points of discussion with the board. (Laurie Bebo Testimony Transcript at 124-26, 267-70, 334-37.)

---

[7] Malen Ng Testimony Transcript at 37-42.

[8] *Id.* at 46-49.

[9] Laurie Bebo Testimony Transcript at 124-26, 267-70, 334-37.

[10] Ms. Bebo's counsel has not been provided access to the testimony transcripts of Grant Thornton personnel.

Based on how follow-up questions to Ms. Ng were framed, Staff appears to minimize the presentation that took place because the auditors may not have specifically tied the discussion to lease covenants. But such a belief does not square with common sense. First, there would be no need for ALC to be recording intercompany revenue related to units leased at the facilities for employees if not for covenant purposes. Second, there would be no reason for the auditor to report on this subject specifically with respect to the CaraVita facilities if it was not pertinent to lease compliance. Third, Ms. Ng herself testified that she understood that employee leasing was used to calculate the Ventas lease covenants, even though it was not specifically stated during her conversation with Grant Thornton prior to the audit committee meeting.

With Ms. Ng's testimony, it is now well-established that the Chair of the Audit Committee, the Company's General Counsel and Chair of the Disclosure Committee, the Company's Internal Auditor, the Company's Director of Financial Reporting, the Company's external auditor, and the full board of directors were all aware of the basic facts related to employee leasing, approved of the practice, and did not raise any concerns about disclosures in the Company's public filings. The SEC will not be able to establish sceinter under these circumstances.

B. No Significant Reaction By Ms. Ng And The Board To The Auditor's Presentation Supports The Conclusion That Ms. Bebo Had Already Discussed Employee Leasing With The Board, And It Approved The Practice.

Significantly, after Ms. Ng discussed the employee leasing with Grant Thornton and having a week or more to reflect upon it, she raised no concerns about the practice at the audit committee meeting. No other board member at the May 2011 audit committee raised any concerns either.[11] This, despite the fact that Mr. Bell testified that he was "hypersensitive to Ventas issues."[12]

This is highly corroborative of Ms. Bebo's testimony that the board approved of the practice -- indeed instructed her to proceed with the practice in February 2009 through Messrs. Hennigar and Rhinelander -- and was comfortable with it until 2012 when other issues caused the Ventas relationship to break down and the sale process changed the dynamics at the Company. There was no reaction in 2011, however, because the board was well-aware that the Company was meeting the Ventas lease covenants through units the Company itself rented for employee use.

Ms. Ng's detailed testimony about Grant Thornton's presentation to the board raises a host of other questions about the accuracy of the other directors' testimony regarding employee leasing generally. For example, it is implausible that employee leasing was not discussed and re-confirmed as being appropriate in connection with the Company's response to the comment letter it received from the Commission only two months later, in July 2011. The comment letter response was discussed and approved at the very next board meeting following the Grant Thornton presentation. Ms. Bebo's testimony establishing a robust discussion of employee leasing in connection with the 2011 comment letter response is far more credible than the directors in this regard.

In addition, every board members' disavowal of any reliance or review of financial and operational information contained in the board packages -- except for management's powerpoint presentation -- is not credible. Indeed, each board members' admission that they did not even look at the

[11] This is particularly significant given that Mr. Buntain may have made his "joke" about filling the CaraVita Facilities up with all employees during this meeting, although Mr. Rhinelander speculated that it was sometime in the Fall of 2011.

[12] Alan Bell Testimony Transcript at 41.

detailed operations analysis, and appendices included in the board packages is a stunning one for a public company director in light of their fiduciary duties and role in compliance with securities laws, particular those that were members of the audit committee like Mr. Bell and Ms. Ng. It is also demonstrably false based on the other testimony they provided and the information contained in the aspects of the board packages upon which they purported to rely.

Finally, the board members' professed concerns about employee leasing and testimony that they would not have approved bonuses for Ms. Bebo and Mr. Buono is contrary to the findings of the audit committee, after it conducted a full investigation into the matter with the representation of a major New York law firm. After months of investigation, the board "determined not to take any action" in response,[13] and took no action against Mr. Buono. He remained with the company until it was sold to new investors.

IV. There Can Be No Securities Fraud Claim Where ALC Had A Reasonable Defense To Any Alleged Breach Of The Lease, And New Testimony Supports This Proposition.

In Ms. Bebo's Wells submission, she established that there can be no securities law violation where the claim is premised upon a company's statement affirming compliance with legal or regulatory obligations, and where the company has a reasonable defense to any potential alleged breach of the legal obligation. (Wells Submission at p. 26.) Additional testimony of Quarles & Brady lawyer Matt Flynn, principal outside litigation counsel to the Company, supports the conclusion that ALC had at least a reasonable defense to any alleged breach claimed by Ventas in relation to the employee leasing arrangement. Mr. Flynn, in his testimony, concluded that he would have been "very comfortable" defending ALC in any potential litigation with Ventas arising out of including rooms set aside for employee use in the occupancy and covenant calculations.[14]

Mr. Flynn's conclusion was based on a clear understanding of the basic facts of the employee leasing practice that he obtained primarily from two conversations with Ms. Bebo in April 2012 (he has notes from the second, more detailed call). Ms. Bebo told him that ALC had discovered that the prior operator of the CaraVita Facilities had counted employees staying at the facilities toward the Ventas lease covenants.[15] She told Mr. Flynn that ALC explained this to Ventas on a telephone call with Joe Solari, also attended by John Buono and Eric Fonstad, and stated that she indicated on that call that ALC would also like to count employees toward the covenants. Mr. Solari did not object.[16]

In the second conversation, Ms. Bebo provided additional details about the employee leasing practice. From this conversation, Mr. Flynn understood that by early 2012, ALC had approximately 100 apartments set aside for employee use which were being counted towards the lease covenants.[17] Importantly, Mr. Flynn understood that not all 100 apartments needed to be occupied in order to be included in the calculations. He did not think 100 employees were visiting the facilities throughout the quarter or that the units were occupied throughout the time they were set aside, and he did not get the

[13] ALC Form 10-Q for the period ending September 30, 2012 at p. 19.

[14] Matt Flynn Testimony Transcript at 30-31, 54-55, although he also acknowledged that the April 26, 2012 Quarles & Brady opinion letter was more circumscribed on its face. In hindsight, he felt that it could have been written more broadly, which would have been more consistent with the views he expressed during his testimony.

[15] *Id.* at 30-31.

[16] *Id.*

[17] *Id.* at 41, 45, 47.

impression that Ms. Bebo was claiming this to be the case.[18] He understood that ALC was "designating" or "setting aside" units.[19]

Ms. Bebo informed Mr. Flynn that ALC accounted for the set aside apartments at the full rate similar to an arms' length transaction, consistent with the telephone conversation with Joe Solari.[20] He understood that ALC accounted for the revenue "internally," and that the practice had been reviewed by the company's outside auditor, Grant Thornton, the chair of the audit committee, and the board of directors.[21] Mr. Flynn concluded that "[j]ust so we're quite clear here, it seemed obvious to me that this process was being done to meet the occupancy covenants." *Id.* at 51.

The fact that Mr. Flynn (or others) may not have been aware of every detail with respect to the circumstances of the various people contained in the lists is irrelevant. Like the others that reviewed the practice (general counsel, inside and outside auditors, and board members), Mr. Flynn had a thorough understanding of the basic operative facts, and concluded that ALC would have a defensible position in any litigation initiated by Ventas.

Mr. Flynn's testimony also demonstrates the consistency of Ms. Bebo's statements to others during the relevant time period (2009 - 2012) and her recollection set forth in testimony in this matter. The quality of her recollection and consistency of her statements is generally unique among witnesses in this case.

CONCLUSION

For the reasons set forth in Ms. Bebo's initial Wells submission and in this supplement, we respectfully submit that the Commission should not bring any charges for alleged securities violations against Ms. Bebo. In addition, the conflicting testimony among the board members amplifies the importance of Ms. Bebo's missing notes pertaining to her conversation with Mr. Solari, board meetings, and discussions with Mr. Rhinelander, among other topics, and our concern about spoliation of the same.

Dated: September 26, 2014

Respectfully submitted,

Mark A. Cameli
mcameli@reinhartlaw.com
Ryan S. Stippich
rstippich@reinhartlaw.com
Reinhart Boerner Van Deuren s.c.
1000 North Water Street, Suite 1700
Milwaukee, WI 53202
Telephone: 414-298-1000
Facsimile: 414-298-8097

[18] *Id.*

[19] *Id.* at 45.

[20] *Id.* at 41.

[21] *Id.*