From ALJ 4-24-19

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17990

In the Matter of

DIGITAL BRAND MEDIA & MARKETING GROUP INC.

Respondent.

RESPONDENT DIGITAL BRAND MEDIA & MARKETING GROUP INC.'S OPPOSITION TO THE DIVISION'S CROSS-MOTION FOR SUMMARY DISPOSITION AND REPLY IN SUPPORT OF RESPONDENT'S MOTION

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Respondent Digital Brand Media and Marketing Group Inc. ("Digital Brand" or "the Company"), by counsel, respectfully submits this memorandum in support of its Motion for Summary Disposition and in Opposition to the Division's Cross-Motion.

Preliminary Statement

In prior submissions to this Court, and again in its cross-motion, the Division encourages the Court to ignore perhaps the most critical facts concerning this Company: the circumstances that caused its filing delays, its ability to make good on its assurances to become current in its reporting, and the damage that would be done to both present and potential shareholders if revocation is ordered. In particular, the Division insists on trying to obscure the reason for the Company's filing issues, claiming that it was a somehow inappropriate response to litigation commenced by a lender, when it is indisputable that the Company's difficulties all stemmed from the SEC's demand that it re-audit years of its activity. Up to that point, the company had been current in its filings and was on the brink of timely filing its 2013 Form 10-K. The SEC's notice that its auditing work would have to be redone, and its refusal to grant any relief to the Company, were substantial and unexpected hurdles created by events having nothing to do with the Company. The need to complete the costly re-audit *also* triggered the lawsuit filed by an aggressive lender, which put additional pressure on the Company's ability to remain current.

The Division has also sought to ignore the Company's ability to bring itself current in its filings so that it can proceed with the growth and development of its business. It ignores the fact that the Company has now regained its footing, notwithstanding substantial obstacles, and has the wherewithal and product to successfully continue its business and remain current.

That the Division continues to press for revocation, notwithstanding the Company's ongoing business operations and demonstrated ability to move forward, appears to run directly

counter to decisional authority and the overarching goal of protection of investors. To the extent that the Division seeks some kind of public statement regarding the seriousness of filing delinquencies, it has abundant opportunities in appropriate cases to obtain that harsh sanction. It should stop trying to obtain that result in *every* case, regardless of the underlying circumstances, and it should not try to make its point at the expense of the shareholders of this Company given these particular circumstances. It could instead seek to make an equally important, and arguably better point, *i.e.*, that if a company has been current in its filings but then encounters unexpected obstacles by virtue of regulatory requirements, the Company should not just throw in the towel and shutter its doors. It should continue to act on behalf of its shareholders and, if it is successful in remedying its noncompliance, it will receive consideration from the SEC for diligent and continuous efforts to return value to its shareholders.

Reply to Division's Statement of Facts

The Division, in its iteration of facts, goes to significant lengths to paint the Company in as negative a light as possible, and its assertions require correction or clarification in a number of areas. First, at the hearing and again in its filing, the Division misstates the record. The Division, for example, claimed at the hearing that Respondent's request for consideration of its public filings was inconsistent with the agreement that the Division reached with Ms. Perry. It must be noted that, when those discussions were occurring with the Division regarding how the matter would proceed post-*Lucia*, the Company did not have counsel. Further, contrary to the Division's claim, Ms. Perry was careful to confirm and the Division agreed that the public filings *would* be part of the record.[1]

[1] By email dated October 19, 2018, Neil Welch confirmed to Ms. Perry that the record would include the materials available to the Court *via* the SEC's public website.

Not only did the Division endeavor to have this matter proceed without consideration of the public filings but also it appears to deny the existence of one of the court filings: Ms. Perry's affidavit of June 20, 2018. At the hearing, the Division put forth a chart referencing the post-filing submissions, but included only the June 1, 2018 affidavit of Ms. Perry and the Declaration of Robert Shapiro, omitting Ms. Perry's June 20, 2018 affidavit. Again in its recent submission, the Division states inaccurately that post-hearing submissions were made through "June 1, 2018." (Division of Enforcement's Brief ("Div.") at 1. As reflected in the Declaration submitted by Respondent on March 19, 2019, in advance of the hearing before this Court, Ms. Perry submitted *two* affidavits in June of 2018; the second one, dated June 20, 2018, addressed *inter alia* Mr. Shapiro's remarks and confirmed the Company's intention and willingness to incorporate Corporation Finance's comments into its filings. Declaration of Maranda Fritz, ¶ 3 and Exhibit B.[2]

The Division also relies in its Motion for Summary Disposition on a series of assertions about Ms. Perry and the Company that are either inaccurate or misleading. It claims that the litigation filed by the funder was based on the Company's *failure* to pay notes that had become due. Div. at 2. In fact, the Company had successfully acquired Digital Clarity in 2010, and until November 2013, had managed and repaid virtually all of more than half a million dollars in loans. When the re-audit requirement was imposed by the SEC in November 2013, the Company was then unable to file its Form 10-K that was only weeks from being finalized and submitted. It was that circumstance, resulting from the re-audit requirement, that caused the payment obligations to the lender *to accelerate and enabled the lender to file suit,* further

[2] In that affidavit, Ms. Perry confirmed that the Company was prepared to amend its filings and then incorporated those comments into the five filings that have occurred since June 2018. The Company will similarly ensure that the comments of Hilda Garrett are incorporated into all future filings and stands ready to make any further amendments to resolve any other issues raised by the Division or Corporation Finance.

exacerbating the repercussions of the SEC's bar of the Company's prior accountant. In the end, that litigation was resolved and the remainder due of $65,000 was paid in June 2018 pursuant to an amended settlement agreement.

The Division also repeatedly carps about the fact that Ms. Perry applied resources of the Company to the defense of the aggressive action filed by the lender, erroneously suggesting that her efforts to comply with regulatory requirements was "lackadaisical." (Div. at 8). The Division even mischaracterizes her testimony, arguing that she stated that she had a duty to protect the Company's "stock price" (Div. at 2); in fact, Ms. Perry stated that she had a moral duty and responsibility to protect *the shareholders*. The record actually confirms that Ms. Perry diligently worked to address the situation created by the SEC's re-audit demand which required her simultaneously to arrange for funding and completion of the re-audit and defend against the effort of the lender, Asher Enterprises, to take control of the Company. Suffice to say that if Ms. Perry had failed to defend against the actions of that lender, a twice sanctioned bad actor in the securities industry,[3] she would plainly have breached her obligations to her shareholders.

Continuing its determined efforts to disparage Ms. Perry, the Division points out that she stated at the hearing that the Company could bring itself current "in 3-6 months," and then accuses the Company of "fail[ing] to meet its own deadlines" (Div. at 7). That parsing of her testimony is unseemly and unfair. First, Ms. Perry was asked to provide an estimate, and she did. That should not be described as a "deadline." Further, Ms. Perry was providing that estimate based on the circumstances that existed as of the date of the hearing. As it turned out, Ms. Perry identified a new auditing firm, Liggett & Webb, which was then engaged on October 16, 2017. That auditor was then able within seven months to familiarize itself with the

[33] It was not until November 2013 that any charges were leveled by the SEC against Asher Enterprises and its principal, Curt Kramer.

Company's business and complete a consolidated Form 10-K covering three years.. Form 10-Qs were then filed on June 22 and 25, 2018, respectively, and the 10-Q for third quarter of 2018 was timely filed on July 15, 2018. A subsequent 10-K FYE 2018 and the 10-Q for the first quarter of 2019 were also filed on time.[4]

The Division also claimed that "there is no evidence as to when Digital Brand received the additional funding" but that "it was not the week after the hearing and was less than promised." Div. at 7-8. In fact, evidence of the receipt of the funding was provided by Respondent on February 6, 2018, and is discussed in audited financial statements beginning with the Form 10 K for 2015-2016-2017 and continuing through the last filing on January 14, 2019. The Company's receipt of $192,000, acknowledged by the Division, was supplemented by further funding of $71,172. Additional funding of $119,899 is reflected in the 10-Q for the second quarter which is being prepared for filing on April 15, 2019. Thus, the Company received funding of $383,071—higher, not lower, than the $313,000 that was discussed by Ms. Perry and referenced by the Division.

Argument

I. The Division Continues to Argue that Revocation is Appropriate in Every Case

The Division, in its prior filing, asserted that revocation is appropriate in every instance in which a company has experienced "an extended period" of noncompliance, regardless of present compliance, citing *Absolute Potential* for the proposition that revocation is still required "as a deterrent to others." Division Brief in Response to Digital Brand's Submission, dated June 2018, at 3.

[4] The Form 10-Q for the second quarter of 2019 will be timely filed on or before April 15, 2019 and we ask that the Court take notice of that fact. The Company therefore became current as of last year and has remained current.

The Division, at the hearing on March 21, 2019 and in its present motion, appeared to pull back from that assertion and acknowledge that the appropriateness of revocation depends on consideration of a host of factors, but it then proceeds to apply those factors in ways that lead ineluctably to the same result, *i.e.*, revocation in every case of a substantial period of noncompliance. All failures to file, the Division argues, are serious and, if lasting two years, are recurrent. A company's inability to file based on financial difficulties, the Division maintains, is only further evidence that the violations were "serious" and "recurrent." Div. Motion at 4. The Division sharply criticizes the Company's use of resources to defend the Asher litigation, turning a blind eye to the fact that the litigation was precipitated by the SEC's re-audit requirement, and that it presented an immediate and substantial threat to the company. Id. at 4-5. The Division derides management for its decision to defend that litigation, evidencing the Division's complete disregard for the very real challenges that a start-up company may face, and the essential obligation of management to take the steps necessary to preserve value for shareholders.

Similarly, the Division effectively equates any knowing failure to file with "a high degree of culpability." Id. at 5-6. Under the Division's analysis, the fact that Ms. Perry was aware of the Company's filing obligations renders her conduct "highly culpable," without regard for the Company's earlier compliance with its filing requirements, the unexpected re-auditing issue, its continuous efforts to cure its delinquencies, and its ultimate success in bringing the Company current. Id at 6.

II. Neither the *Gateway* Factors Nor Decisional Authority Supports Revocation

Consideration of the authorities that address these *Gateway* factors supports a different outcome. A company's failure to file is certainly serious and the violation in this case was also recurrent, but the decisions reflect that more extensive periods on noncompliance, *e.g.*, five years in *Absolute Potential*, are and should be met with more severe sanctions.

As for culpability, the decisions reflect that an abject and unexplained failure to file is highly culpable, distinct from a demonstrated pattern of compliance followed by a particular circumstance that leads to a period of non-filing. The former bespeaks a disregard for regulatory requirements, while the latter reflects active and diligent management making tough decisions for a company that has limited resources. This case presents a more compelling circumstance than exists in any of the cited decisions: the failures to file were the direct result of an unusual, unexpected and costly regulatory demand, and the Company's need and diligent *efforts to deal with that regulatory demand* should not be viewed as a willful or deliberate failure to comply with its *other* ongoing regulatory requirements. [5] To the contrary, it demonstrates that the violations here were not culpable.

Consideration of these three factors, and the decisions that have applied them, confirms that this case is not the equivalent of those in which revocation has been ordered. The violations here were serious, as they are in any case, but the period of noncompliance was less substantial than existed in other cases in which the company's registration was revoked. And the Division failed to establish any significant degree of culpability. These factors do not support the harsh sanction of revocation sought by the Division.

That leaves consideration of the remaining *Gateway* factors: the extent of the issuer's remedial efforts and the credibility of its assurances of future compliance. These *Gateway* factors unquestionably tip the balance in favor of the Company, and render revocation a punitive measure that would result in unwarranted harm to shareholders. This case is, in fact, strikingly similar to the circumstances in *In the Matter of Can-Cal* in which Judge James E. Grimes

[5] The Commission in *Impax Laboratories*, Release No. 3-12519 (May 23, 2008), did not find "high culpability" in relation to that company's failures to file. The Commission confirmed that the Impax's failure to file "was not the result of a complete disregard" of the accounting issue that arose. The Company made continuous "efforts to comply with its reporting obligations." *Id.* at 12-13. Its registration was revoked, however, because it made "repeated unfulfilled promises to file," it failed to become current in its reporting obligations, and its investors remained, therefore, without access to current, audited financial statements." *Id.* at 13-14.

recently denied the SEC's Motion for Summary Disposition. Release No. 6525 (March 28, 2019). In *Can-Cal*, the company stopped filing its periodic reports for approximately two years because *inter alia* it "lacked funds due to the shareholder litigation." Order Denying the Division of Enforcement's Motion for Summary Disposition at 2. It then, in March 2018, filed a comprehensive Form 10-K for fiscal years 2015 and 2016, later filed an annual report for fiscal year 2017 and timely filed three Form 10-Qs for 2018. *Id.* at 3-4.

There, as here, the Division, argued that "regardless of Can-Cal's recent efforts to become current, revocation was appropriate under Commission precedent, particularly *Absolute Potential, Inc.*" *Id.* at 4, 7. In its denial of the Division's motion for summary disposition, the Court found that while the violations were serious and recurrent, "revocation is not automatic, particularly when the company has made significant efforts to come into compliance." *Id.* at 7 (citing *e-Smart Techs. Inc*, Release No. 505014 (Oct. 12, 2004).[6] As plainly stated by the Court in *e-Smart* and reiterated in *Can-Cal,* "subsequent filing history is an important factor to be considered in determining whether revocation is necessary or appropriate for the protection of investors." *Id.*

The Court in *Can-Cal* then easily distinguished the particular circumstances in *Absolute Potential.* Specifically, the court noted that, in *Absolute*, the company had provided only an "unilluminating" explanation of why the company failed to comply with its reporting obligations, it was a shell company, and it was likely to violate the reporting requirements in the future. *Can-Cal*, on the other hand, "is not a shell company," it has agreements in place that will

[6] During the hearing on March 21, 2019, this Court expressed the view that e-Smart had not continued its filings after the proceedings in 2004 and 2005. In fact, e-Smart continued to file for many years after those events, through and including a Form 10-K filed in June of 2009.

ensure revenue to pay the audit firm, and it had timely filed periodic reports for a year.[7] "These facts," the court found, "distinguish *Can-Cal* from every case the Division cites." *Id.* at 8. The Court concluded that "the Division has not met its burden on summary disposition to show that revocation of Can-Cal's securities is necessary for the protection of investors despite the company's efforts to become current and its assurances that it will remain current." *Id.* at 11. *See also Global Digital Solutions Inc.*, File No. 3-18325 (Section 12(j) proceeding dismissed on March 17, 2019 where company became current in its filings and the Division would carefully monitor the company to ensure its future compliance).

Here, as in *Can-Cal*, the Division takes a reflexive approach, claiming that the Company's filings remain "deficient" and encouraging this Court to conclude that bringing a company current can *never* cure a filing deficiency because "the Commission has previously held that the filing of current audited financial statements does not cure the failure to file audited financial statements from an earlier time period." Div. at 8. And, the Division continues, a consolidated 10-K cannot cure filing failures because "Rule 13a-1 requires the filing of a separate annual report." *Id.* Thus, for the sake of trying to obtain the revocation of Digital Brand, the Division abjures the SEC's own statements confirming that, where a deficiency has occurred but "the investing public now has access to current, audited financial information," the Company's filing of its annual and quarterly reports "is an important factor to be considered in determining whether revocation is 'necessary and appropriate for the protection of investors." *e-Smart,* Release No. 50514 (Oct. 12, 2004) & 2005 WL 274086 (Feb. 2, 2005).[8]

[7] In *Can-Cal*, as here, the Division argued that Can-Cal "is not really current" because it failed to file certain 10-Qs. The *Can-Cal* Court did not accept the notion that failure to file quarterly reports during periods covered by audited annual reports would constitute a basis for revocation. *Id.* at 9 & n. 49. The Court confirmed that the filing of a comprehensive Form 10-K, even without the filing of interim quarterly reports, still brings the company "current."

[8] The Division continues to follows the playbook of *Can-Cal*, asserting now that the Company did not file proxy information yearly elections. Div. at. 9. The Court in *Can-Cal* responded to a similar claim by noting that the Division had failed even to raise the issue until the midst of the proceedings.

III. The Division Has Failed to Establish That The Company's Remedial Efforts Are Deficient

Also, as in *Can-Cal*, the Division devises other claims to support its goal of revocation. It points to the statement from Corporation Finance suggesting that the Company's MD&A is not "balanced" because it incorporates industry metrics that lack a "clear correlation" to the company's business. Div. at 8-9. But that kind of subjective evaluation does not render the filing deficient. The Company does consider that broader industry information relevant to a business that operates in a web-based and global environment. Further, the Division does not and could not suggest that the discussion is in any way inaccurate or misleading, particularly when properly viewed in the context of the company's financial disclosures.

That the Division is not entitled to summary disposition is clear from the circumstances here and consideration of comparable cases. As stated by the Court in *Can-Cal*, the fact that a company has revenues and/or funding, is not a shell, and has an explanation for its filing deficiencies that confirms its diligent efforts, all distinguish this "situation from any case the Division cites." *Can-Cal* at 8. The Division has not met its burden to show that revocation is necessary and appropriate for the protection of investors.

IV. Respondent's Motion for Summary Disposition Should be Granted

Respondent, on the other hand, has put forth undisputed facts demonstrating that this proceeding should be dismissed. On each of the critical *Gateway* factors, the evidence confirms that the Company has a compelling explanation for its filing deficiencies; it was actually its need to comply with a different and unexpected bar of the Company's auditor, and the litigation that flowed from that, that rendered the Company unable to remain current. It is undisputed that the

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The Division has also added a claim from Hilda Garrett that the companies description of its review of its internal controls is deficient. Div. at 11. The Company maintains that the issue regarding the particular phrasing used by the Company does not render the filing materially deficient but also the Company has incorporated Corporation Finance's prior comments into its subsequent filings and will likewise incorporate Ms. Garrett's comments into all future filings.

Company then pressed on, raising additional funds, identifying an auditor to prepare the Company's filings, and providing to the Court an estimate of the length of time that would be necessary to become current. The Company then, consistent with its assurances to the Court, brought the Company current. The Company has also assured the Court that it will remain current and here, unlike in Can-Cal, it has a history of timely filings, and revenues and funding available to ensure compliance. Given those circumstances, Respondent's motion for summary disposition should be granted rather than engaging in further proceedings in this matter.

Conclusion

For the reasons set forth above and in its Motion for Summary Disposition, Respondent respectfully requests that the Administrative Law Judge deny the Division's request for revocation and grant Respondent's Motion for Summary Disposition.

Dated: April 4, 2018

Respectfully Submitted,

Maranda E. Fritz
Thompson Hine LLP
335 Madison Avenue
New York, New York 10017

Counsel for Digital Brand

CERTIFICATE OF SERVICE

I hereby certify that true copies of Respondent Digital Brand Media & Marketing Group Inc.'s Motion for Summary Disposition, and the Declaration of Maranda E. Fritz in Support of Respondent's Motion for Summary Disposition were served on the following on this 19th day of March, 2019, in the matter indicated below:

By Email:

The Honorable Carol Fox Foelak
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April 4, 2019

Honorable Carol Fox Foelak
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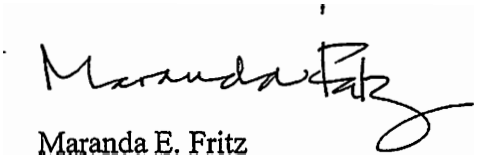
RE: ***In the Matter of Digital Brand Media & Marketing Group, Inc.***

Dear Judge Foelak:

Attached please find a courtesy copy of Respondent Digital Brand Media & Marketing Group, Inc.'s Reply in Support of its Motion for Summary Disposition and Opposition to the Division's Motion for Summary Disposition.[1]

If you have any questions, please do not hesitate to contact me.

Respectfully submitted,



Maranda E. Fritz

Enclosure

cc: James M. Carlson, Esq.
Samantha M. Williams, Esq.

[1] Because this submission incorporates both the reply in support of Respondent's motion and the opposition to the Division's motion, I conferred with the Division regarding a filing date; they agreed to a filing date of April 5, 2019.

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