

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 79820 / January 18, 2017

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3848 / January 18, 2017

ADMINISTRATIVE PROCEEDING
File No. 3-17794

In the Matter of

**KENNETH MACK and BRYAN
McMILLAN**

Respondents.

**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 21C OF THE SECURITIES
EXCHANGE ACT OF 1934, MAKING
FINDINGS, AND IMPOSING CEASE-AND-
DESIST ORDERS AND PENALTIES**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), against Kenneth Mack (“Mack”) and Bryan McMillan (“McMillan”) (collectively “Respondents”).

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (“Offers”), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over them and the subject matter of these proceedings, which are admitted, and except as provided in Section IV.E herein, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Cease-and-Desist Orders and Penalties (“Order”), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds¹ that:

SUMMARY

This matter concerns the conduct of Kenneth Mack ("Mack") and Bryan McMillan ("McMillan") in connection with a financial restatement that occurred at Orthofix International, N.V. ("Orthofix"). During the relevant period, McMillan served as the President of Orthofix's largest segment – its Spine Segment – and Mack reported to him as a Vice President of Global Sales and Development responsible for the international portion of Orthofix's Spine Segment. During the relevant period, Orthofix had an unwritten policy requiring that any modifications made to contractual, payment, or other related terms with international distributors be approved by the Chief Financial Officer of Orthofix's Spine Segment ("Spine CFO") before any final agreement occurred. During the relevant period, however, Respondents agreed to terms on two transactions with one of Orthofix's largest distributors without the Spine CFO's approval. Mack additionally negotiated transactions with two other international distributors containing various concessions without the Spine CFO's knowledge or approval. Moreover, in connection with a fiscal year 2012 audit conducted by Orthofix's independent auditors, Mack provided an inaccurate representation.

As a result of the foregoing conduct, Mack and McMillan violated Exchange Act Section 13(b)(5) and Rule 13b2-1 and were a cause of Orthofix's violations of the reporting and books and records provisions of the federal securities laws. Mack additionally violated Exchange Act Rule 13b2-2(b) through his inaccurate representation to Orthofix's independent auditors.

RESPONDENTS

Kenneth Mack, age 45, served as the Vice President of Global Sales and Development for the international portion of Orthofix's Spine Segment from March 2011 until May 2013 and is no longer employed at Orthofix.

Bryan McMillan, age 46, served as Orthofix's Spine Segment President from November 2011 through November 2012 and is no longer employed at Orthofix.

¹ The findings herein are made pursuant to Respondents' Offer and are not binding on any other person or entity in this or any other proceeding.

FACTS

A. Orthofix's Business and Structure

1. Orthofix's business was primarily divided into two Global Business Segments during the relevant period – Spine and Orthopedics. During the relevant period, Spine was Orthofix's largest segment and contributed two-thirds of the company's overall revenues.
2. Spine had several operating divisions during the relevant period including Orthofix Spinal Implants ("OSI"), which was responsible for international sales of spinal implants and related instruments.
3. Spine sold products through various methods, including selling its products to international distributors who then sold the products to hospitals and physicians.
4. As Spine Segment President, McMillan was in charge of Spine's sales and overall management. McMillan had several sales persons who worked under him, including Mack.
5. As Spine's Vice President of Global Sales and Development, Mack was in essence the relationship manager for a number of relationships that OSI had with certain international distributors. Mack had a sales team of approximately four employees who reported to him and had day-to-day responsibility for certain distributor relationships.

B. Distributor Business and Revenue Recognition Practices

6. Orthofix entered into written agreements with distributors of its product. These distributor agreements provided, among other things, standard payment terms for purchase of products. These standard payment terms ranged typically from 90 to 180 days.
7. During the relevant period, Spine had an unwritten policy requiring that modifications to the terms in existing distributor agreements be approved by the Chief Financial Officer of the Spine Segment ("Spine CFO"). The Spine CFO reported directly to McMillan and indirectly to the Orthofix CFO who was a principal executive officer of the company.
8. The Spine CFO's approval authority in this regard extended to all aspects of distributor agreement terms, including pricing, commissions, discounts, extensions of payment terms, payment plans, returns, and exchanges.
9. With limited exceptions, Orthofix recognized revenue during the relevant period based on the "sell-in" method, which provides for revenue recognition upon shipment of products to the distributor.

10. ASC 605-10-25-1 provides that revenue may be recognized only when it is both realized or realizable and earned. Consistent with the authoritative literature, Orthofix's financial statements disclosed four criteria as its revenue recognition policy.
11. The four criteria are: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred or services have been rendered; (iii) the seller's price to the buyer is fixed and determinable; and (iv) collectability is reasonably assured.

C. McMillan and Mack Imposed Pressure to Meet Internal Sales Targets

12. During the relevant period, Orthofix had a culture of aggressively setting internal sales targets and imposing pressure upon its sales personnel to meet those targets. For example, on October 22, 2011, McMillan emailed Mack and others concerning the need for OSI to meet its fourth quarter forecast of \$6 million in revenue. McMillan wrote "if we fail at this endeavor then the company will be at risk and next year will be Hell on Earth for all of us."
13. Less than one year later – and again reflecting the pressure imposed to meet revenue targets – Mack sent the following email on August 28, 2012 to his sales team with the subject line "September Gut:"

I need your gut feeling on the revenue we can generate in September. We need \$2 million in addition to what is on the portal . . .based on the feedback I have received I have gotten so far, we are off about \$1.5 million. I know what people say they need, but as you know this is important. We need to ask everyone to purchase just a bit more . . .if I have to walk into [McMillan's] office and tell him we are short again, that is going to be a major problem.

14. After receiving the above email, one of the sales persons who reported to Mack emailed a colleague separately and wrote:

I was just speaking with [Mack] and had finance listened to us last year we wouldn't be in this mess. We all predicted our markets could not sustain this growth but they got greedy. Found this budget brutal because here we are for another year just estimating the dollars.

D. Mack and McMillan Negotiate Transactions and Term Amendments with Brazilian Distributor

15. OSI had several international distributors during the relevant period, but its largest distributor of product was located in Brazil (hereinafter "the Brazilian Distributor"). In fact, for eight of the nine quarters from Q1 2011 to Q1 2013, the Brazilian Distributor was the Company's second largest customer on a revenue per quarter basis.

16. Entering 2012, the Brazilian Distributor's amounts payable to Orthofix was approximately \$11 million. In March 2012, McMillan and Mack had discussions with the Brazilian Distributor to address this issue. The Brazilian Distributor agreed to pay approximately \$4.2 million of the amounts payable by the end of FY 2012 but only if the company delivered certain products by the end of April 2012. Orthofix did not, however, deliver the products by the end of April 2012.
17. In late May 2012, the Brazilian Distributor President and McMillan had a face-to-face meeting. As reflected in June 2012 email communications among the Brazilian Distributor President, McMillan, Mack, and other employees, the Brazilian Distributor President and McMillan discussed two things at that meeting.
18. First – since Orthofix had not delivered the products that the Brazilian Distributor had insisted upon by the end of April 2012 – the Brazilian Distributor President informed McMillan (and later Mack through June 2012 emails memorializing those discussions) that it would only pay \$1.6 million of its amounts payable in December 2012 and \$2.6 million in February 2013.
19. Second, McMillan discussed a product launch plan with the Brazilian Distributor to purchase approximately \$2.5 million of an FDA approved Orthofix product called Firebird. This product, however, had not yet been approved by ANVISA (the Brazilian equivalent of the U.S. Food and Drug Administration), and therefore, could not be shipped into Brazil until such approval was obtained by the Brazilian Distributor. Neither Mack nor McMillan knew exactly when ANVISA would grant approval.
20. As reflected by June 2012 emails between the Brazilian Distributor, Mack, and McMillan, the Brazilian Distributor agreed to place the Firebird order on the following conditions: (i) one year to pay for the product contingent on ANVISA approval and (ii) 210 days to pay on all subsequent product orders.
21. Mack and McMillan agreed to the payment plan proposal and the Firebird order terms without approval from the Spine CFO.
22. The Spine CFO learned of the Firebird transaction a few weeks after the Firebird product had already been shipped. In particular, on July 24, 2012 Mack forwarded the Spine CFO an email describing the transaction along with a series of emails containing prior discussions among him, McMillan, other employees, and the Brazilian Distributor's President.
23. The Spine CFO replied to both McMillan and Mack “[Ken], can you please address how we ended up with a full year to pay for the June order. I have a hard time managing that with a lot of pressure to reduce our ballooning [Days Sales Outstanding].” Mack replied, “we accepted this due to the need for that size of an order.”

24. Orthofix recognized over \$2 million in revenue from this transaction immediately upon shipping the implants to the Brazilian Distributor's U.S. based subsidiary located in Atlanta, Georgia. In particular, Orthofix's recognition of revenue in this regard was improper because the Brazilian Distributor's obligation to pay, and the payment terms themselves, were contingent upon ANVISA approval and, therefore, revenue recognition was inconsistent with Orthofix's accounting policy because it did not meet the fixed or determinable criteria or the collectability criteria.
25. On December 1, 2012, Mack emailed the Brazilian Distributor's President and the Spine CFO and wrote "I believe you have been speaking with [the Spine CFO] about the end of the year payment of \$4 million. They are all extremely anxious about this. This has to happen as agreed." By this time, McMillan had left the company.
26. The Brazilian Distributor's President replied "No [the Spine CFO] did not communicate with me, certainly because it is quite clear this was agreed with [McMillan]. We will pay \$1.6 million in December."
27. Mack forwarded this email to the Spine CFO, writing "this is a disaster," despite the fact that Mack had been informed in June 2012 that the Brazilian Distributor would only pay \$1.6 million in December 2012 as a result of the failure to deliver certain products by April 30, 2012.
28. Ultimately, Orthofix filed its FY 2012 Form 10-K in March 2013 and did not, among other things, adequately assess the collectability of the significant receivables it had with the Brazilian Distributor.

E. Mack Improperly Negotiates Transactions with Spanish and Mexican Distributors

29. In July 2012, Mack, without getting the approval of the Spine CFO, solicited a Spanish Distributor of Orthofix product to place an \$810,000 order in which he offered the distributor certain concessions, which he characterized as the "deal of the century." The concessions included extended payment terms on the order and the right to return \$250,000 of excess distributor inventory that resulted from the order. The Spanish Distributor placed this order.
30. In September 2012, Mack, again without getting the approval of the Spine CFO, solicited a Mexican Distributor of Orthofix product to place a \$300,000 order in which he offered the Distributor a number of concessions. The concessions included extended payment terms on the order, payment of \$60,000 in taxes for the Distributor to the Mexican tax authorities, expansion of sales territory and reduction in sales quotas for the next year. The Mexican Distributor placed this order.
31. Orthofix recognized revenue from these transactions upon shipment of the products. This was improper because payment terms and timing were contingent upon certain extra-

contractual concessions and, therefore, revenue recognition was inconsistent with Orthofix's accounting policy because it did not meet the fixed or determinable criteria or the collectability criteria.

F. Mack Makes Inaccurate Representation to Auditors

32. Mack made an inaccurate representation to Orthofix's independent auditors in connection with their audit of the fiscal year 2012 financial statements.
33. In particular, under the direction of the-then Spine President (who was a principal executive officer of the company), Mack provided a misleading written representation to the independent auditor that stated inaccurately that the sales for which Mack was responsible did not include side agreements outside the terms of the sales contracts, extended payment terms, rights of return, or concessions.

G. Orthofix's Restatement

34. Orthofix materially misstated several of its annual and quarterly filings and corresponding earnings releases, failed to make and keep books and records which, in reasonable detail, accurately and fairly reflected the transactions and dispositions of the assets of the issuer, and failed to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in conformity with generally accepted accounting principles.
35. Accordingly – in late March 2014 – Orthofix restated its financial statements for the first quarter of fiscal year 2013, all quarterly and annual periods in fiscal years 2012 and 2011, and the annual period for fiscal year 2010 and acknowledged certain material weaknesses in its internal control over financial reporting.

VIOLATIONS

36. Under Section 21C of the Exchange Act, the Commission may impose a cease-and-desist order upon any person who is violating, has violated, or is about to violate any provision of the Exchange Act and upon any person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation.
37. Section 13(a) of the Exchange Act requires issuers to file such periodic and other reports as the Commission may prescribe and in conformity with such rules as the Commission may promulgate. Exchange Act Rules 13a-1, 13a-11, and 13a-13 require the filing of annual, current, and quarterly reports, respectively. In addition to the information expressly required to be included in such reports, Rule 12b-20 of the Exchange Act requires issuers to add such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are

made not misleading. “The reporting provisions of the Exchange Act are clear and unequivocal, and they are satisfied only by the filing of complete, accurate, and timely reports.” *SEC v. Savoy Industries*, 587 F.2d 1149, 1165 (D.C. Cir. 1978) (citing *SEC v. IMC Int’l, Inc.*, 384 F. Supp. 889, 893 (N.D. Tex. 1974)). A violation of the reporting provisions is established if a report is shown to contain materially false or misleading information. *SEC v. Kalvex, Inc.*, 425 F. Supp. 310, 316 (S.D.N.Y. 1975).

38. Section 13(b)(2)(A) of the Exchange Act requires issuers to “make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.”
39. Exchange Act Section 13(b)(5) prohibits any person from knowingly circumventing or knowingly failing to implement a system of internal accounting controls or knowingly falsifying any book, record, or account described in Exchange Act Section 13(b)(2).
40. Exchange Act Rule 13b2-1 prohibits any person from, directly or indirectly, falsifying or causing to be falsified, any book, record, or account subject to Exchange Act Section 13(b)(2)(A).
41. Exchange Act Rule 13b2-2(b) prohibits any officer or director of an issuer or any other person acting under the direction thereof from directly or indirectly taking any action to mislead an accountant engaged in the performance of an audit if that person knew or should have known that such action, if successful, could result in rendering the issuer’s financial statements materially misleading.
42. As a result of the conduct described above, Mack and McMillan violated Exchange Act Section 13(b)(5) and Rule 13b2-1 and were a cause of Orthofix’s violations of Exchange Act Sections 13(a) and 13(b)(2)(A) and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder. Mack additionally violated Exchange Act Rule 13b2-2(b).

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents’ Offers.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondents shall cease and desist from committing or causing any violations and any future violations of Exchange Act Sections 13(a), 13(b)(2)(A), 13(b)(5) and Rules 12b-20, 13a-1, 13a-11, 13a-13, and 13b2-1 thereunder. Respondent Mack shall further cease and desist from committing or causing any violations and any future violations of Exchange Act Rule 13b2-2(b).

B. Within 30 days of the entry of this order, Mack shall pay a civil money penalty of \$40,000 and McMillan shall pay a civil money penalty of \$25,000. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

C. Payment must be made in one of the following three ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request²;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofin.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying the Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Antonia Chion, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5720.

D. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the penalties referenced in paragraph IV.B above. This Fair Fund may be added to or combined with the fair fund established in *In the Matter of Orthofix International, N.V.*, (AP File No. 3-17791; Release No.10281, January 18, 2017) and/or may be added to or combined with fair funds established for the civil penalties paid by other Respondents for conduct arising in relation to the violative conduct at issue in this proceeding or the Orthofix proceeding, in order for the combined fair funds to be distributed to harmed investors affected by the same violative conduct. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of

² The minimum threshold for transmission of payment electronically is \$1,000,000. For amounts below the threshold, respondents must make payments pursuant to option (2) or (3) above.

any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

E. It is further ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondents, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary

DMS4415287v7