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., *et al.*

Respondents.

DIVISION OF ENFORCMENT'S REPLY BRIEF IN SUPPORT OF CROSS-MOTION FOR SUMMARY DISPOSITION

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The Division of Enforcement ("Division") respectfully submits its Reply Brief in support of its Cross-Motion for Summary Disposition against Respondent Digital Brand Media & Marketing Group, Inc. ("Digital Brand").

ARGUMENT

Digital Brand recasts binding Commission precedent as the Division's litigation position and then lays out policy arguments for a different approach.[1] Neither the litigants nor the Administrative Law Judge is free to disregard Commission precedent. That precedent establishes that the *Gateway* factors are the legal framework for determining the appropriate sanction for filing failures and that the facts of this case mandate the sanction of revocation.[2]

I. Digital Brand Concedes its Violations are Serious and Recurrent.

Digital Brand criticizes the Division's "argument" that filing failures lasting more than two years are serious and recurrent. That is not the Division's argument; that is the Commission's precedent. As it must, Digital Brand ultimately concedes that its violations ***are*** serious and recurrent. "A company's failure to file is certainly serious and the violation in this case was also recurrent[.]" Opp. at 6. Digital Brand next argues that if, under Commission precedent, filing failures lasting two years are serious and recurrent, every filing failure lasting two years would "lead ineluctably" to revocation. *Id.* Digital Brand's own authority

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[1] *See, e.g.*, Opp. at 2 (arguing that the Division could make a "better point" by not seeking revocation and that the Commission could better achieve its goal of shareholder protection if, in determining the appropriate sanction, it considered a company's efforts to return value to shareholders).

[2] The *Gateway* factors are: (1) the seriousness of the issuer's violations, (2) the isolated or recurrent nature of the violations, (3) the degree of culpability involved, (4) the extent of the issuer's efforts to remedy its past violations and ensure future compliance, and (5) the credibility of its assurances, if any, against further violations. *Gateway Int'l Holdings, Inc.*, Exchange Act Release No 53907, 2006 WL 1506286, at *4 (May 31, 2006).

demonstrates the illogic of this argument. Even where a company has committed serious and recurring violations, the consideration of other *Gateway* factors might weigh against revocation. Opp. at 8 (citing *e-Smart Techs. Inc.,* Release No. 505014 (Oct. 12, 2004)). The *Gateway* factors are not an illusory path to a lesser sanction, they simply do not justify a lesser sanction in this case.

II. Digital Brand's Evidence does not Mitigate Culpability.

Digital Brand does not dispute that it made an intentional decision – which it found "easy," "responsible," and "moral" – to spend money on litigation with its creditor rather than on its filing obligations. **Ex. 7** at ¶¶14, 16. This is remarkably similar to the decision by the issuer in *Citizens Capital*, which candidly stated that it had decided "to temporarily suspend its periodic financial reporting requirements, and the related expenses thereof, in favor of reallocating its time and financial resources towards insuring [sic] the continuance and ongoing progress of the Company and its subsidiaries in meeting its various goals and objectives." *Citizens Capital Corp.*, Exchange Act Release No. 67313, 2012 WL 2499350, at *4 and n.7 (June 29, 2012). The Commission found the issuer's intentional decision evidenced a high degree of culpability. *Id.* at 4.

It is likewise undisputed that Digital Brand was aware the required filings were not being made;[3] that Digital Brand repeatedly filed late 12b-25 notices; that the late filing of 12b-25 notices persisted after the Division of Corporate Finance ("Corp. Fin.") issued its delinquency notice;[4] and that over a year passed between issuance of the delinquency notice and Digital

[3] **Ex. 1** at 86:2-5, 87:1-11; 94:24-95:2; 98:15-17; 103:13-15.

[4] **Ex. 12; Ex. 6B; Ex. 10.**

Brand's purported cure.[5] Under Commission precedent, this is also evidence of a high degree of culpability.

Digital Brand does not contest that its 12b-25 statements misleadingly suggested that the company would be able to file reports, just not timely ones, and that filing the reports was a "priority" that would be accomplished "as soon as possible." In reality, Digital Brand lacked resources to prepare any reports because Digital Brand prioritized paying for litigation with Asher over paying for its reports to be prepared as soon as possible.

To mitigate this evidence, Digital Brand cites evidence purportedly showing that its noncompliance was caused by Corp. Fin.'s re-audit demand and that Digital Brand has a track record of compliance. Assuming, without conceding, that the re-audit demand caused Digital Brand's noncompliance,[6] third-party causation does not mitigate culpability. "While we consider culpability as a factor under *Gateway*, we have previously rejected the argument that an issuer cannot be held accountable for filing delinquencies if the delinquencies resulted from the actions of a third party." *Cobalis Corp.,* Exchange Act Rel. No. 64813, 2011 WL 2644158, *6 (July 6, 2011) (evidence that noncompliance was caused by creditor, who allegedly forced the company into bankruptcy for the purpose of taking over, was irrelevant in determining

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[5] **Ex. 10; Ex. 11; Ex. 9** at ¶6.

[6] The basis for Digital Brand's causation claim appears to be that if, in 2013, Corporation Finance had not required Digital Brand to submit audited reports from a qualified auditor when Digital Brand's auditor was disqualified, Digital Brand would not have defaulted on its loan agreements with Asher, which would not have sued Digital Brand in 2014, which suit would not have depleted Digital Brand's funds over the next year-and-a-half, resulting in Digital Brand's choice, in December 2015, to stop funding compliance in favor of funding the Asher litigation. *But see Calais Res., Inc.,* Exchange Act Release No. 67312, 2012 WL 2499349, at *5 (June 29, 2012) (issuer's delay in filing reports was attributable to issuer's failure to timely engage auditor, not Corporation Finance's failure to provide issuer with opinion as to whether auditor had disqualifying interest).

culpability). Indeed, the Commission has viewed an issuer's efforts to blame third parties for noncompliance as troubling. *Gateway*, 2006 WL 1506286, at *4 (by blaming subsidiaries for failing to give issuer access to books and records required to complete audit, issuer "has not accepted responsibility for its failure to meet its reporting obligations").

Assuming, again without conceding, that Digital Brand had a track record of compliance before the filing failures raised in the Order Instituting Proceedings,[7] under Commission precedent, a track-record of compliance coupled with third-party causation still does not mitigate culpability. *See, e.g., Citizens Capital*, 2012 WL 2499350 at *2, *4 (evidence that company had timely filed reports for almost three years and only stopped filing because its key management resigned and its business was adversely affected by terrorist attack was insufficient to overcome evidence that company's failure to file continued for years and was the result of an intentional decision).[8]

[7] Digital Brand does not dispute that: (1) it has never filed proxy or information statements regarding the yearly director elections required by Florida, Digital Brand's state of incorporation and (2) that it failed to timely file insider trading forms. *See* **Ex. 6A** and **Fritz Dec.** at Ex. B, p.3 (conceding insider trading forms were filed two years late).

[8] *See also China-Biotics, Inc.*, Exchange Act Release 70800, 2013 WL 11270156, at *2, *7 (Nov. 4, 2013) (evidence that company had timely filed reports for four-and-a-half years and only stopped filing because of newly-discovered accounting irregularities was insufficient to overcome evidence that company "did not file a single periodic report for more than a year and a half . . . . despite multiple warnings and the institution of these proceedings"); *American Stellar Energy, Inc. a/k/a Tara Gold,* Exchange Act Release No. 64897, 2011 WL 12905129, at *2, *4 (Jul. 18, 2011) (evidence that company had timely filed reports for almost two years and only stopped filing because it replaced its existing line of business was insufficient to overcome evidence that company knew it had an obligation to file, repeatedly failed to file, and continued noncompliance after being warned).

III. Digital Brand's Attempts to Remedy Past Violations are Materially Deficient under Commission Precedent and *Can-Cal Resources, Ltd.*

Digital Brand does not dispute that its only attempt to cure the missing quarterly and annual reports was through a "Super" 10-K, which the Commission has squarely held is insufficient. *Calais*, 2012 WL 2499349 at *6; *Tara Gold*, 2011 WL 12905129 at *5. Digital Brand seeks to distinguish *Calais* and *Tara Gold* by attributing them to the Division. But these are not the Division's statements; they are binding Commission holdings.

Digital Brand next cites Judge Grimes' decision denying summary disposition in *Can-Cal Resources, Ltd.*, Release No. 6525 (March 28, 2019) for the proposition that a consolidated 10-K ***can*** cure a missing filing. What Judge Grimes said was "It is at least arguable, however, that as long as the consolidated report contains no material deficiencies, the issuer could be considered current in its filings." *Id.* at 9, n.49. Since Corp. Fin. did not find any deficiencies in Can-Cal's consolidated report, Judge Grimes held that Can-Cal's Super 10-K was distinguishable from those addressed in *Tara Gold* and *Calais*, which were materially deficient. *Can-Cal,* at 3 and 9, n.49. Whether Judge Grimes was correct in distinguishing *Tara Gold* and *Calais* is not at issue here because Digital Brand's Super 10-K did contain material deficiencies. *See* **Ex. 14** at ¶4.

Digital Brand's Super 10-K is deficient under Commission precedent because, among other things, it does not state a conclusion regarding the effectiveness of the company's internal controls over financial reporting ("ICFR").[9] Digital Brand does not point to any

[9] *See China-Biotics,* 2013 WL 11270156, at *8-9 (issuer's failure to include required information about ICFR was a material deficiency); *Tara Gold,* 2011 WL 12905129 at *5 (same). *See also* 17 CFR § 229.308 (requiring an issuer to include in its annual report a "statement identifying the framework used by management to evaluate the effectiveness" of ICFR, management's "assessment of the effectiveness of" ICFR, and "a statement as to whether or not [ICFR] is effective."

language in the Super 10-K that it claims includes the required ICFR disclosures. Digital Brand simply states that it does not agree that an ICFR omission is a material deficiency. **Fritz Dec.** at Ex. B, p3. That Digital Brand does not agree with Commission precedent does not make it any less binding or establish a factual dispute over Digital Brand's compliance.[10]

IV. Digital Brand's Assurances of Future Compliance are Incredible.

An issuer's ability to meet self-imposed deadlines, implementation of concrete, effective measures to remedy the cause of the violations, and subsequent compliance all bear on the credibility of the issuer's assurances of future compliance. *Absolute Potential, Inc.* Exchange Act Release No. 71866, 2014 WL 1338256, *7-8 (Apr. 4 2014); *Tara Gold,* 2011 WL 12905129, at *4-5.

A. Digital Brand's Subsequent Filings Demonstrate there has been no Concrete Change in Digital Brand's Compliance Perspective or Finances.

Digital Brand made an intentional choice to not pay for compliance because it believed its funds should be spent on what it perceived to be more important matters. Digital Brand has put forth no evidence that compliance has assumed more importance now than it did previously. In fact, Digital Brand's post-Super 10-K filings and litigation statements show it has not. Among other things, in response to Corp. Fin.'s June 2018 Declaration pointing out the Super 10-K's deficiencies, Digital Brand stated that it "did not agree" with that assessment and would only amend the Super 10-K if the Commission deemed it necessary. **Fritz Dec.** at Ex. B, p3. Although the June 2018 Declaration put Digital Brand on notice that its annual reports needed to include an ICFR effectiveness conclusion, the annual report Digital Brand filed on

[10] Digital Brand urges the Administrative Law Judge to follow *Global Digital Solutions, Inc.*, Exchange Act Release No. 85364 (March 19, 2019), where the Commission granted the Division's request to dismiss the proceedings to "preserve the Commission's resources." *Id.* at *3. Here, the Division has determined it has the resources to prosecute this case.

December 14, 2018 contained the same omission as its previous reports. *Compare* **Ex. 14** at ¶4 *with* **Ex. 16** at ¶4. Digital Brand's response is to again claim that it does not believe the ICFR omission is material. Opp. at 10, un-numbered footnote.[11]

If Digital Brand had truly changed its view about the importance of compliance, at a minimum, it would have ensured that the annual report filed after Corp. Fin.'s June 2018 Declaration included the required ICFR statements. Digital Brand's decision to disregard Corp. Fin.'s guidance unless the Commission deems it necessary is compelling evidence that Digital Brand has a "highly troubling attitude towards Commission reporting requirements." *America's Sports Voice, Inc.*, Exchange Act Rel. No. 55511, 2007 WL 9421706, *3 (March 22, 2007).

Viewing its compliance failure not as an intentional choice, but a simple lack of funds, Digital Brand also compares itself to *Can-Cal* where, as described by Digital Brand, Can-Cal had "agreements in place that will ensure revenue to pay the audit firm[.]" Opp. at 8-9 (citing *Can-Cal*, Release No. 6525 at 8 where third-party was contractually obligated to pay Can-Cal $150,000 per year for 20 years, which would more than cover audit fees). Digital Brand has put forth no evidence of a revenue-ensuring agreement similar to that in *Can-Cal* and its 2018 annual report shows that it was $394,817 short on the revenue needed to pay its 2018 expenses. **Ex. 15** at F-3.

B.e Digital Brand has Failed to Meet its own Compliance Estimates.e

At the August 9, 2017 hearing, Ms. Perry first testified that she had $313,000 in funds to pay for compliance work "as of yesterday," then as of "last week." **Ex. 1** at 108:17-109:13. When pressed, Ms. Perry testified that she would have the funds "this week" and, finally, the

[11] Digital Brand also seems to suggest that it only learned of the deficiency from the recently-filed Declaration of Hilda Garret. Setting aside the fact that Digital Brand is responsible for compliance on its own initiative, Corp. Fin. did provide Digital Brand with specific guidance about the ICFR omission in its June 2018 Declaration. *See* **Ex. 14** at ¶4.

week after the hearing, *i.e.*, by August 18, 2017. *Id.* In its opening brief, the Division submitted evidence that none of Ms. Perry's funding predictions proved accurate – by August 18, 2017, Digital Brand had not received any funding and the funding that did arrive later was less than predicted. Digital Brand misses the point by arguing that, in the year-and-a-half after August 18, 2017, it received enough funding to exceed $313,000 (albeit not enough to pay its yearly expenses). Commission precedent is not concerned with the amount of funds received, but whether the issuer's predictions are reliable. The undisputed evidence shows that Digital Brand's compliance-funding predictions were not.

Digital Brand's prediction that it would file its delinquent annual reports within three to six months of the hearing also proved to be unrealistic. Digital Brand argues that it is "unseemly and unfair" for the Administrative Law Judge to consider the missed date because it was only an estimate. That is what Commission precedent requires and there is nothing unfair about it. Future events can only be estimated; they cannot be guaranteed. The fact that an issuer's estimates do not turn out to be accurate – either because the issuer underestimates the amount of time required, the funds needed, or the effect of external events – is probative as to the reliability of the issuer's estimates of future compliance. *See, e.g., Nature's Sunshine Prods.*, Exchange Act Release No. 59268, 2009 WL 137145, at *3, *6 (January 21, 2009) (issuer's failure to file on date predicted was relevant to credibility even though the date was not a "firm estimate" and qualified by statement that auditor was "not willing to put a line in the sand and say ... it will be done by this date or not by that date"); *Impax Labs., Inc.*, Exchange Act Release No. 57864, 2008 WL 2167956, at n.27 (May 23, 2008) (fact that issuer failed to cure delinquencies by date projected was relevant to credibility notwithstanding the fact that projected date was an "estimate").

CONCLUSION

Digital Brand concedes that its filing failures were serious and recurrent. Digital Brand's own statements establish that the noncompliance that led to this proceeding was the result of an intentional decision. That is evidence of a high degree of culpability. Similarly, Digital Brand made the intentional decision not to amend the Super 10-K it relied upon to cure its delinquency because, among other things, it disagreed with Corp. Fin.'s assessment (and Commission precedent) that an ICFR omission is a material deficiency. Digital Brand has not changed its compliance perspective as evidenced by the fact that it subsequently filed an annual report with the same omission for the same reason – its belief that Corp. Fin. is wrong. Digital Brand's assurances of future compliance were already highly suspect given its track record of unreliable estimates for compliance funding and filing. But its actions are dispositive. Having twice refused to do what its regulator said was required, Digital Brand cannot credibly be heard to claim it will comply with its regulator in future. Revocation is the appropriate sanction here.

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CERTIFICATE OF SERVICE

I certify that, on April 10, 2019, I caused the Division of Enforcement's Reply Brief in Support of the Division's own Motion to be e-mailed to the following:

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