INITIAL DECISION RELEASE NO. 893
ADMINISTRATIVE PROCEEDING
FILE NO. 3-16293

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of LAURIE BEBO and JOHN BUONO, CPA	INITIAL DECISION October 2, 2015

APPEARANCES: Benjamin J. Hanauer, Daniel J. Hayes, Scott B. Tandy, Timothy J. Stockwell, and Eric M. Phillips for the Division of Enforcement, Securities and Exchange Commission

Mark A. Cameli, Ryan S. Stippich, Jennifer L. Naeger, Alexander B. Handelsman, and Lisa Nester Kass, Reinhart Boerner Van Deuren s.c., for Respondent Laurie Bebo

BEFORE: Cameron Elliot, Administrative Law Judge

SUMMARY

This Initial Decision: (1) finds that Respondent Laurie Bebo (Bebo) violated and caused violations of Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5, Bebo caused violations of Exchange Act Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) and Rules 13a-1 and 13a-13, and Bebo violated Exchange Act Section 13(b)(5) and Rules 13a-14, 13b2-1, 13b2-2; (2) imposes a cease-and-desist order from committing or causing the above-listed violations; (3) orders Bebo to pay a civil penalty of $4,200,000; and (4) imposes an officer-and-director bar on Bebo.

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I. INTRODUCTION

A. Procedural Background

The Securities and Exchange Commission (Commission) commenced this proceeding on December 3, 2014, with an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) pursuant to Sections 4C and 21C of the Exchange Act and Commission Rule of Practice 102(e). Bebo filed an Answer on January 5, 2015. The proceeding as to Respondent John Buono, CPA (Buono) settled. *Laurie Bebo*, Exchange Act Release No. 74177, 2015 SEC LEXIS 347 (Jan. 29, 2015).

Thirty-one witnesses testified during a hearing held in Milwaukee, Wisconsin, over nineteen days, on April 20-24 and 27-30, May 1 and 4-7, and June 15-19, 2015. The admitted exhibits are listed in the Record Index issued by the Office of the Secretary on September 14, 2015. The Division of Enforcement (Division) and Bebo filed post-hearing briefs and briefing was complete on August 31, 2015.[1]

B. Summary of Allegations

This proceeding concerns alleged fraud in disclosures filed with the Commission. OIP at 1. More specifically, the OIP alleges as follows: Bebo and Buono were, respectively, the CEO and CFO of Assisted Living Concepts, Inc. (ALC), a publicly-traded assisted living and senior residence provider headquartered in Menomonee Falls, Wisconsin. *Id.* In 2008, ALC entered into a lease with Ventas, Inc. (Ventas), a real estate investment trust (REIT), to operate eight assisted living facilities in the southeast United States (the Facilities). *Id.* at 3. Between 2009 and 2012, ALC failed to comply with certain occupancy and financial covenants in the lease. *Id.* at 1. Bebo and Buono hid ALC's lack of covenant compliance by fabricating occupants, and by conveying documentation to Ventas which included the fabricated occupants and their associated revenue. *Id.* at 1-2. Bebo and Buono misrepresented ALC's covenant compliance, among other misstatements and omissions, in various Forms 10-K and 10-Q filed between 2009 and early 2012.[2] *Id.* at 2, 8-9. Based on these factual allegations, the OIP alleges that Bebo thereby

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[1] Citations to the transcript of the hearing are noted as "Tr. __." The parties filed joint exhibits, with the exception of three exhibits submitted by Bebo. Citations to the joint exhibits are noted as "Ex. __." The page numbers of certain exhibits are cited to by the last non-zero numerical digits of their Bates numbers. The Division's and Bebo's post-hearing briefs are noted as "Div. Br. __" and Resp. Br. __," respectively. The Division's and Bebo's reply briefs are noted as "Div. Reply Br. __" and "Resp. Reply Br. __," respectively.

[2] The OIP clearly alleges that Bebo's scheme began no later than the first quarter of 2009. *See* OIP at 7 (ALC sent Ventas false quarterly financial statements for Facilities starting in the first quarter of 2009); *see generally* OIP at 8-10 (summarizing violations occurring between the first quarter of 2009 and the fourth quarter of 2011). However, the OIP twice alleges that aspects of Bebo's scheme started only in the third quarter of 2009. *See* OIP at 2 (Bebo "certified the accuracy of ALC's representations" in Forms 10-K and 10-Q starting in the third quarter of

violated Exchange Act Section 10(b) and Rule 10b-5 thereunder, and violated or caused the violation of various provisions of Exchange Act Section 13 and Rules thereunder, as well as Exchange Act Rule 12b-20. *Id.* at 10-11.

In her Answer, Bebo denies most key allegations. *See generally* Answer. She also asserts seventeen affirmative defenses, most of which are not discussed in her post-hearing briefs. *Id.* at 10.

II. BASIC FINDINGS OF FACT

The findings and conclusions herein are based on the entire record. All documents and exhibits of record have been fully reviewed and carefully considered. I have determined all facts based on the preponderance of the evidence. *See Steadman v. SEC*, 450 U.S. 91, 102 (1981). I have considered and rejected all arguments, proposed findings, and conclusions that are inconsistent with this Initial Decision.

A. Background

ALC was spun off from Extendicare Health Services, Inc. (Extendicare), in 2006, as a public company traded on the New York Stock Exchange. Tr. 1767; Ex. 5 at 1, 3. ALC owned and operated senior living facilities throughout the United States, and as of March 31, 2009, operated 216 assisted and independent living residences in twenty states, totaling 9,287 units. Ex. 2 at 6; Ex. 5 at 4. As of December 31, 2011, ALC had annual revenues of $234,452,000, annual net income of $24,360,000, and approximately 4,200 employees. Ex. 13 at 8, 19. A holding company owned by the family of David Hennigar (Hennigar), a Canadian resident, possessed voting control of ALC, and Hennigar served as ALC's chairman of the Board of Directors (Board). Tr. 547-48, 553. Bebo was a senior executive of Extendicare, and after ALC was spun off she became its CEO and a member of the Board. Tr. 1764, 1767, 3814.

Ventas is a REIT focused on healthcare. Tr. 159. In 2008, it owned roughly 500 properties, including the Facilities. Tr. 162, 165; Ex. 2106 at 83. Prior to 2008, the Facilities had been leased and operated by CaraVita (sometimes referred to as "Old CaraVita"). Tr. 165. The arrangement between CaraVita and Ventas essentially was a lease, with the operator responsible for expenses and upkeep, and retaining any cash flow above the rent payments. Tr. 164-66.

In 2007, ALC negotiated with Ventas to take over as the lessee of the Facilities. Tr. 167-68, 1535, 1777; Exs. 1564, 1564A. Bebo favored entering into the Lease, and presented the matter to ALC's Board. Tr. 548, 2803, 3885-86. Bebo signed the Lease on behalf of ALC and its operating subsidiaries, and the Lease became effective on January 1, 2008. Ex. 142 at 8699, 8794-96. On January 7, 2008, ALC filed a Form 8-K outlining pertinent terms of the Lease, including the financial covenants described *infra*, and attaching the Lease as an exhibit. Ex. 1.

2009), 6 (ALC included non-residents in the covenant calculations starting in the third quarter of 2009). I construe this as a scrivener's error.

B. Terms of Ventas Lease

The Lease was complex, even by the standards of senior living facility leasing. Ex. 2185 at 11-12. Several provisions are at issue.

The rent increased from year to year, from a low of $4,473,500 in the first year to a high of $5,778,254.61 in the tenth and final year. Ex. 142 at 8710-11, 8800. ALC guaranteed the Lease. *Id.* at 8706, 8715. Each Facility was to be used only for its primary intended use. *Id.* at 8718. CaraVita Village's primary intended use was independent living and assisted living; the other Facilities' primary intended use was assisted living and Alzheimer's care. *Id.* at 8797. Otherwise, no Facility was to enter into any transaction with ALC, or any other Facility, except in the ordinary course of business, on terms fully disclosed to Ventas in advance, and on terms no less favorable to any Facility than would be obtained in a comparable arm's-length transaction with an unrelated third party. Ex. 142 at 8720. No Facility could change its licensed bed capacity, except that a Facility could, apparently at its discretion, remove ten percent of beds from service. *Id.* at 8722, 8797. The Lease could only be modified by a writing signed by representatives of Ventas and of the relevant Facility. *Id.* at 8782.

The Lease also had covenants. The basic affirmative covenant was that each Facility was required to perform all of its Lease obligations. Ex. 142 at 8724. Also, in the event of a complaint to a governmental authority alleging non-compliance with a licensing requirement, the Facility involved was to notify Ventas and remedy any condition causing the complaint. *Id.* at 8727. In general, failure to meet any covenant, where that failure was not cured within thirty days after notice from Ventas, constituted a default. *Id.* at 8749. However, in the case of a complaint to a governmental authority alleging non-compliance with a licensing requirement, failure to notify Ventas and remedy the condition causing the complaint was considered a default even without notice from Ventas. *Id.* at 8748-49. Certain adverse regulatory actions also constituted defaults. *Id.* at 8750-51.

The most pertinent Lease provisions, however, were the financial covenants, remedies in event of default, and record keeping and reporting requirements. The financial covenants included required coverage ratios and minimum average occupancies. Ex. 142 at 8726. The Lease defined coverage ratio as the ratio of the Facility's cash flow to the sum of each Facility's rent, other lease payments, and other debt service, if any. *Id.* at 8829. The Lease defined cash flow, in turn, as the net income of each Facility as reflected on that Facility's income statement, with several additions and subtractions, including addition of the management fee actually charged to the Facility and subtraction of an imputed management fee not exceeding six percent. Tr. 336; Ex. 142 at 8720, 8828. In essence, cash flow was EBITDAR[3] minus a $300 reserve and a six percent imputed management fee, with "flexibility" in setting the actual management fee. Tr. 335-37. Timothy A. Doman (Doman), senior vice president and chief portfolio officer of Ventas, testified that Ventas' lessees charge various actual management fees, including four, five, six, and eight percent. Tr. 335-36.

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[3] Earnings before interest, taxes, depreciation, amortization, and rental expense. *See SEC v. Spiegel, Inc.*, No. Civ. A. 03 C 1685 (N.D. Ill. Sept. 15, 2003), 2003 WL 22176223, at *91 n.87; *see also* Ex. 142 at 8830.

Occupancy, by contrast, was not defined in the Lease. Tr. 323-24, 3894-95. This was an intentional omission, because different operators calculated occupancy differently. Tr. 332. Ventas was most concerned with calculating occupancy consistently over time, and did not require operators to change their calculation method just to accommodate Ventas. Tr. 332. ALC tracked “actual occupancy” using a system called TIPS. Tr. 2765.

The specific covenant requirements, as measured at each quarter end, were as follows:

1. Coverage Ratio for each Facility, for the trailing twelve month period – 0.8.
2. Coverage Ratio for portfolio, for the trailing twelve month period – 1.0.
3. Minimum Average Occupancy for each Facility – 65%.
4. Minimum Average Occupancy for each Facility, for the trailing twelve month period – 75%.
5. Minimum Average Occupancy for all Facilities in the aggregate, for the trailing twelve month period – 82%.

Ex. 142 at 8726.

Failure to meet these financial covenants was deemed a default. Ex. 142 at 8748. Remedies for default included termination of the Lease, surrender of the Facilities to Ventas, and payment of the remaining rent due on the Lease as liquidated damages. *Id.* at 8751-53. This last provision was known at ALC as “accelerated” lease payments, and they were estimated to be approximately $16.7 million as of December 31, 2011. Tr. 1446, 3632; Ex. 13 at 43; Ex. 295 at 122836-37.

Each Facility was required to maintain “proper and accurate books and records in accordance with [Generally Accepted Accounting Principles (GAAP)], and a standard modern system of accounting, in all material respects reflecting the financial affairs of each [Facility] and the results from operations of each Facility.” Ex. 142 at 8766. Each Facility was required to deliver to Ventas annual and quarterly financial statements. *Id.* at 8766-67. Required in the financial statements were: “Patient Revenues and other revenues itemized by payor type”; “patient census information by payor type”; net operating income; and an occupancy report. *Id.* at 8767. An Officer’s Certificate, certifying that each financial statement was complete, accurate, and prepared in accordance with GAAP, was required as to each Facility. *Id.* at 8767, 8843. Failure to meet the reporting obligations was deemed a default if not cured within ten business days after a notice of default from Ventas. *Id.* at 8748-49.

C. The Phone Call and Follow-Up Email

Although Buono was heavily involved in negotiating the Lease, he had misgivings about ALC’s ability to meet the financial covenants. Tr. 2313-14; Ex. 140. ALC’s general counsel, Eric Fonstad (Fonstad), had similar misgivings, as did ALC Board members Alan Bell (Bell) and Derek Buntain (Buntain); in fact, Bell and Buntain abstained when the Lease came up for a vote by the Board. Tr. 549-50, 552-53, 1298-1300, 1355-57. Bebo, however, supported entering into the Lease and was comfortable that ALC could meet the financial covenants, and so informed at least one Board member, Mel Rhinelander (Rhinelander). Tr. 1780-81, 2804.

Bell asked for regular reports from management about covenant compliance, which management then prepared and transmitted to the Board quarterly. Tr. 2807-08. By late October 2008, four Facilities required "[i]mmediate improvement" in their coverage ratios, a view conveyed to the Board at the November 2008 Board meeting in a memorandum from Buono. Tr. 558; Ex. 150 at 30461; *see* Ex. 147. By December 2008, Buono believed ALC would eventually default on the Lease covenants, and discussed that possibility with Bebo. Tr. 2334-35. To address the problem, Bebo determined that ALC would seek to include employees in covenant calculations, after concluding that Old CaraVita had employed a similar practice. Tr. 2339.

Bebo arranged a telephone conference with Joseph Solari (Solari) for January 20, 2009. Tr. 413-14; Ex. 175. Solari was Ventas' managing director of acquisitions, and was responsible for "sourcing and executing the acquisition of healthcare facilities." Tr. 399. He generally had no responsibility for asset management after an acquisition, although in ALC's case he stayed involved to "explore ways to do future business together," and also because he was new at Ventas and "didn't have a lot to do." Tr. 399, 409. Prior to the call, Fonstad had participated in discussions about including employees and their relatives in covenant calculations, provided they stayed at Facilities. Tr. 1307-08, 1311. Bebo backed this idea. Tr. 1308. When Fonstad heard that Bebo intended to call Ventas and float the idea, he prepared a memorandum "outlining the parameters that [Fonstad] thought applied to the question." Tr. 1309-10, 2340; Ex. 1152. Fonstad pointed out three provisions of the Lease – pertaining to transactions with affiliates, modification of the Lease, and the Facilities' primary intended uses – that he believed should be addressed. Tr. 1313-14; Ex. 1152. Fonstad also drafted a follow-up "template" letter that would confirm any agreement reached between ALC and Ventas. Tr. 1315-18, 1504; Ex. 1152. He emailed the memorandum and template letter to Bebo and Buono on January 19, 2009. Exs. 1046, 1152.

The next day, January 20, 2009, Buono emailed Bebo with his thoughts on ALC's "danger points" for fourth quarter 2008. Tr. 2340-42; Ex. 174. Buono identified two Facilities, namely, Peachtree Estates and Greenwood Gardens, that were in danger of failing multiple specific covenants. Tr. 2341; Ex. 174. Buono based his analysis on preliminary numbers for the quarter, and suggested in the email that ALC could do "adjustments" of numbers, as it did at the end of every quarter, to satisfy the covenants. Tr. 2342.

The call took place as scheduled on January 20, 2009; Bebo and Buono participated on the call for ALC, but Fonstad did not, and Solari participated for Ventas. Tr. 414, 1504-05, 1556, 2343. The participants discussed two topics: the leasing of units to a hospice company, and whether certain ALC corporate employees, while traveling to a Facility, could stay in vacant Facility units instead of staying in a hotel. Tr. 414, 450, 2343. Solari agreed to nothing, and he told Bebo and Buono to put ALC's proposal in writing. Tr. 415, 2344-45. The participants did not discuss covenant calculations. Tr. 416, 2344.

After the call, Bebo directed Buono to include employees in the covenant calculations. Tr. 2347-48. Buono understood that Solari did not agree to that, but Buono also understood that "that's the way it was going to be, and [he] wouldn't be around too long without it." Tr. 2348. Bebo also told Buono not to tell Ventas that employees were being included in the calculations, or to tell Ventas covenant numbers that did not include employees. Tr. 2348-49. Fonstad never

advised Bebo or Buono that ALC's inclusion of employees in covenant calculations was acceptable, nor was he ever asked to opine on the practice. Tr. 1518-21, 2347, 2380-81.

Eventually Solari asked Buono for a written memorialization of the January 20, 2009, call. Tr. 2466-67. Buono sent Bebo an email on January 27, 2009, asking if Bebo had sent any communication to Solari, and offering to draft it. Tr. 2466-67; Ex. 1319. Buono drafted the body of a letter in Fonstad's presence, and forwarded it to Bebo on January 27, 2009. Tr. 2354, 2467-68, 2757; Exs. 1320, 1320A. Bebo had ultimate control over the email's contents, however. Tr. 2354.

Buono's initial draft, and Bebo's eventual email, principally addressed ALC's proposed arrangement with the hospice company. Exs. 184, 1320A. However, they also briefly addressed renting rooms to employees. The pertinent language in Buono's initial draft consisted, in its entirety, of one paragraph:

> In addition to the potential hospice lease, we are also confirming our notification of our rental of rooms to employees and/or family members. We confirm that all rentals related to either employees or family members 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.

Ex. 1320A. Bebo's version of the paragraph, however, omitted mention of family members:

> In addition to the potential hospice lease, we are also confirming our notification of our rental of rooms to employees. We confirm that all rentals related to employees are in the ordinary course of business and on terms no less favorable than would be obtained in a comparable arms-length transaction with an unrelated third party.

Ex. 184; *see* Tr. 2469.

Bebo sent Solari the email on February 4, 2009, with the subject line "Update from our last conference call – talk with you soon." Ex. 184. Bebo's paragraph was not consistent with Solari's understanding; he understood that ALC was requesting permission for ALC corporate employees to stay in Facilities when traveling for business purposes. Tr. 426-27. Solari wanted to get Ventas' asset management group involved in the discussion, so he forwarded Bebo's February 4, 2009, email to Doman and Bill Johnson (Johnson) later that day, asking if Johnson would follow up. Tr. 427-28; Ex. 184. After being told that Johnson would follow up, Solari informed Bebo of that fact, also on February 4, 2009. Ex. 186. This was apparently the only follow up to Bebo's February 4, 2009, email from Ventas, and ALC personnel never thereafter discussed with Ventas the inclusion of ALC employees in covenant calculations. Tr. 429.

D. The Covenant Calculation Process and ALC's Performance Thereunder

ALC calculated occupancy based on the number of occupied units, which was determined in the first instance by TIPS. Tr. 512, 516. A unit was considered occupied if it had

a resident who had taken "financial responsibility" for the unit, that is, who had a signed lease agreement and/or had paid for the unit. Tr. 512-13. TIPS was used to generate each Facility's financial statements, and the data in TIPS was periodically subject to verification by field audits. Tr. 512, 516, 519. The number of occupied units was then divided by the total number of units to obtain the occupancy percentage. Tr. 516, 519. This was the standard method ALC used for calculating occupancy company-wide at all relevant times, and ALC never included employees who stayed at non-CaraVita properties in those properties' respective occupancy calculations. Tr. 830, 3010, 4545-46. This was because TIPS needed to track "paying resident[s]." Tr. 3028-29.

The process initially differed slightly for calculating the Ventas financial covenants. *See* Tr. 519 ("to make the occupancy out of our systems at the same basis as the lease"). Specifically, occupancy information in each Facility's financial statement was adjusted for cut-out apartments – two adjacent units which had been joined and could only be rented as one unit – and for companion units – two-person units that were treated as fully occupied under the Ventas Lease if only one person resided in the unit, but which TIPS counted as half-occupied. Tr. 520-21. The number of occupied units was then divided by the number of units recited in the Lease to obtain the occupancy percentage. Tr. 520-21. Both the cut-out and the companion adjustments resulted in increased occupancy rates. Tr. 520-21.

1. Fourth Quarter 2008 to Second Quarter 2009

Beginning in the first quarter of 2008, ALC forwarded documents to Ventas to demonstrate, among other things, that it was in compliance with the financial covenants. Tr. 749; *see, e.g.*, Ex. 32. The Lease required ALC to forward such documents, and ALC did so until February 2012, using a spreadsheet supplied by Ventas. Tr. 763; Ex. 45; Ex. 142 at 8766-67. From the first quarter of 2008 to the second quarter of 2009, the ALC employee forwarding the financial covenant documents to Ventas was Robin Herbner (Herbner), a former CPA who had been a field accounting manager at ALC since 2006. Tr. 750, 857, 879-80; Exs. 32-34. For the first three quarters of 2008, the Facilities met the financial covenants, based on the calculation method outlined above. Tr. 750.

In October 2008, Herbner projected that two Facilities, Greenwood Gardens and Peachtree Estates, would fail the fourth covenant requirement (75% individual occupancy for the trailing twelve months) in the fourth quarter of 2008, and so informed Buono. Tr. 750-52; Ex. 548 (spreadsheet showing that projected occupancy for trailing twelve months as of December 31, 2008, was 74% for Greenwood Gardens and 74.9% for Peachtree Estates). Herbner attended ALC's December 2008 Board meeting, at which Bebo informed the Board that all Ventas financial covenants would be met at the end of 2008; Herbner, however, was not so confident. Tr. 753-54. In fact, just before the January 20, 2009, call involving Bebo, Buono, and Solari, Herbner ran some covenant calculations, at Bebo's request, and determined that Peachtree Estates needed over $40,000 additional income to achieve the desired coverage ratio. Ex. 174 (Peachtree needed $161,813 but only had $117,988).

In January 2009, after the fourth quarter of 2008 had ended, Herbner understood that employees who had occupied a room at a Facility – that is, who had stayed or slept at a Facility –

would be included in the financial covenant calculations for the fourth quarter of 2008. Tr. 757. Herbner understood this because Buono told her that Bebo had "had a conversation with Ventas allowing the practice." Tr. 797. Bebo agreed that employees who stayed certain nights at Facilities were included in the covenant calculations for the fourth quarter of 2008. Tr. 1987, 1989.

Herbner accordingly emailed Bebo on January 22, 2009 (two days after Bebo and Buono's call with Solari), seeking "a list from someone of the employees that have occupied a room at one of the [Facilities] to complete the covenant calculations." Ex. 176. Bebo provided the requested list, and Herbner either contacted the employees to determine the days they had stayed at the properties, or learned the number of days from Bebo. Tr. 798-99, 802. Herbner then adjusted each Facility's financial statement to account for employees. Tr. 796; Ex. 141 at 32689. Herbner's working papers for calculating occupancy were called the "recon tab" or "occupancy recon." Tr. 792-93.

Herbner also calculated the relevant coverage ratios. Tr. 814. ALC recorded each Facility's employee-related revenue through journal entries, with credits to each Facility and debits to an ALC-wide account known as the "997 account" or "997 entity." Tr. 808-09; Exs. 378, 550. The journal entries were meant to represent, in effect, that rent for employee stays was paid out of the 997 account to each Facility. Tr. 810. Herbner calculated the imputed revenue amounts by multiplying the total number of days attributed to each employee stay by the daily rental rate. Tr. 822-24; Ex. 206 at 31559. Although the rate for employees apparently changed over time, during at least one quarter it was the same as the rate for Facility residents. Tr. 805-06, 823-24. Bebo told Herbner what rates to use. Tr. 806, 824, 886. Although Bebo denied knowing until relatively recently that the ALC-wide account was called the 997 account, she understood at the time that ALC had a "corporate entity to consolidate or to cancel out or to disperse expenses or revenues across buildings," and testified that she explained the use of the corporate entity to Rhinelander in the "very beginning." Tr. 4133-35, 4195-96, 4585-86.

Herbner forwarded the revenue amounts to Anthony Ferreri (Ferreri), ALC's assistant controller, who posted the associated journal entries to ALC's general ledger. Tr. 825, 1222-23. The 997 account accumulated debits, which were booked as "negative revenue," and which were, in effect, allocated to ALC's 203 other facilities in ALC's consolidated financial statements. Tr. 1119-21. Ferreri, a CPA, did not know why the accumulated debits in the 997 account were booked as negative revenue, he was simply "told to record it this way." Tr. 1220, 1243. According to Ferreri, "there was no standard or consistent method or description" in journal entries related to the Facilities. Tr. 1271. In Ferreri's view, the "standard" accounting treatment would have been "revenue someplace, expense someplace," and ALC's practice of accumulating negative revenue in the 997 account was "definitely not consistent with GAAP." Tr. 1243-44. Ferreri "wasn't exactly comfortable" with "this whole process," and he asked for, and received, "executive management sign-off on journal entries," that is, Bebo and Buono authorized all journal entries related to the 997 account. Tr. 1246-48, 1275-76. This was the only time in his career that he requested a CEO or CFO to approve a journal entry, and to back up his request, he cited Sarbanes-Oxley, although he did not know "all the details of the law." Tr. 1248.

Herbner then used each Facility's financial statements, which incorporated the imputed revenues from employees, to calculate coverage ratios. Tr. 757-58, 761, 802-03; Ex. 141 at 32686. Herbner forwarded to Ventas the package of documents required by the Lease, which included covenant calculations, Facility financial statements, and Officer's Certificates, by email on February 12, 2009. Ex. 32. For the fourth quarter of 2008, Herbner had to revise the coverage ratios because Ventas wanted to use a different rent amortization schedule; she transmitted the revised package on February 16, 2009. Tr. 764-65; Ex. 549. Neither the original nor the revised package disclosed that ALC employees were used in the covenant calculations. Tr. 764-65. At least five employees were counted in the covenant calculations for the fourth quarter of 2008, divided among three different Facilities, totaling 333 employee-days, and resulting in approximately $25,000 in imputed revenue. Ex. 141 at 32689.

For the first and second quarters of 2009, the financial covenant calculation process changed. Tr. 817, 827-28. Herbner "was doing projections frequently" to monitor covenant compliance, and she projected that one Facility would fail a covenant; namely, that Winterville would fail the first covenant requirement (0.8 trailing twelve month Facility coverage ratio). Tr. 811-13; Ex. 199. Despite "receiv[ing] two names from [Bebo]" at a previous meeting, Herbner determined that Winterville still needed five more employees included in the covenant calculations for the entire quarter to meet the required coverage ratio, and communicated her determination to Bebo on April 13, 2009. Tr. 812-13; Ex. 199. Bebo again provided Herbner the rental rates for calculating the coverage ratio, and Herbner again forwarded the revenue amounts to Ferreri, before ever knowing the identities of the designated employees. Tr. 824-26. That is, instead of documenting actual employee stays and incorporating those stays into the covenant calculations, as she did for the fourth quarter of 2008, Herbner determined the number of employees needed to meet the covenants, communicated that number to Bebo and the associated negative revenue to Ferreri, received a list of employees from Bebo without obtaining supporting evidence of their stays, and then finalized the covenant calculations. Tr. 816-17.

Bebo agreed that starting with the first quarter of 2009, "accounting" determined the number of units needed, and it then "would typically ask [her] for names for those numbers of apartments," in at least some instances after the end of the quarter. Tr. 1988. She also agreed that she "generally" provided the names. Tr. 4077.

Herbner believed at the time that it was "unlikely" that five employees had actually stayed at Winterville for the entire first quarter of 2009. Tr. 814. Herbner was also "concerned" that the identified employees were inappropriate. Tr. 817. In particular, she was concerned about using Gale and Bill Bebo, Bebo's parents, and Kevin Schweer (Schweer, sometimes spelled Schewer), the ex-husband of an ALC employee. Tr. 818; Ex. 206 at 31559; Ex. 1378. Neither Bill Bebo nor Schweer were employees at the time, and, although Gale Bebo was known at ALC by that name, Bebo asked Herbner to list Gale and Bill Bebo using the last name "Paremsky" (sometimes spelled Paremski), which was Gale Bebo's maiden name.[4] Tr. 818, 853.

[4] As explained *infra*, other non-employees were later designated for use in covenant calculations, as well. For convenience, this ID refers to all persons other than actual paying residents or customers designated as occupants, and whose occupancy and imputed revenues were included in covenant calculations, as "employees," even when they were not actually employed by ALC.

Another of Herbner's concerns was that at least four employees were listed at two properties for the same time period. Tr. 819-20; Ex. 206 at 31559. Specifically, Herbner listed: Paula Carlo (Carlo) at both Greenwood and Winterville for the entire quarter; Io Schug at both CaraVita Village and Winterville for the entire quarter; and Jared Houck (Houck) and Kathy Bucholtz (Bucholtz) at both Peachtree and Winterville for the entire quarter. Ex. 206 at 31559.

Herbner considered the covenant calculations for the first quarter of 2009 to be a "turning point," because to her it stopped making business sense "as to why Ventas would allow such a practice," and because it was clear that, contrary to her original understanding, the listed employees did not actually stay at the Facilities. Tr. 818-20. Nonetheless, Herbner continued preparing the list of "designated" employees so that it was readily available, such as for production to ALC's auditors. Tr. 820, 850; Ex. 1374. Herbner made no effort to verify the list of employees because the list came from Bebo directly, and because Herbner did not think she could get supporting documentation. Tr. 820-21. Although Herbner did not use ALC's whistleblower hotline to express her concerns about the covenant calculations, she did talk to David Hokeness (Hokeness), ALC's director of internal audit. Tr. 858-59.

Herbner forwarded the package of documents for the first quarter of 2009 to Ventas by email on May 15, 2009. Ex. 33. Herbner's covenant calculation procedure for the second quarter of 2009 was the same as for the first quarter of 2009, and she forwarded the associated package of documents to Ventas by email on August 12, 2009. Tr. 827-29; Ex. 34. Neither package disclosed that ALC employees were used in the covenant calculations. Tr. 814, 826.

ALC began recording revenue imputed to employees monthly instead of quarterly after Ventas inquired why revenues spiked at the end of each quarter. Tr. 831. Herbner continued calculating revenue shortfalls monthly, and generally before the employees to be included were identified; indeed, the employees were generally identified at the end of the quarter. Tr. 831-32. Bebo agreed that employees were identified at the end of the quarter, although "there were some instances where it may be on a monthly basis." Tr. 1988.

Herbner never told Ventas that ALC was including employees in covenant calculations. Tr. 832-33. Herbner felt it "would have been an issue" if she had communicated with Ventas without the approval of Bebo or Buono. Tr. 833. In July 2009, a Ventas employee asked Herbner to explain "some significant increases in occupancy" between the fourth quarter of 2008 and the first quarter of 2009. Ex. 211. Herbner emailed Bebo and Buono, stating that she felt she needed "some help with the explanations." *Id.* Buono and Herbner then called Bebo, and Bebo dictated the explanations, which were then provided to Ventas. Tr. 835-36; Ex. 212. The use of employees in the occupancy calculations was not cited as an explanation, even though occupancy at both Winterville and Peachtree would have declined without the inclusion of employees. Tr. 837-38, 840; Ex. 212. Bebo, who "knew occupancy like the back of her hand," agreed that Herbner's response to Ventas said nothing about "employee-set-aside apartments," and that, "[g]enerally speaking," Bebo gave Herbner the answers to forward to Ventas. Tr. 838, 2091-92.

Also, couples (such as Gale and Bill Bebo) are counted as a single employee when they are listed as occupying a unit together.

Herbner went on maternity leave in August 2009, and returned right after Thanksgiving. Tr. 845. While on maternity leave, Herbner found other employment, and she gave notice her first week back at ALC and left in December 2009. Tr. 844-46. One of the reasons Herbner left ALC was that she did not want a leadership role in a company "that was constantly pushing the edges of regulators"; Herbner was on the verge of tears when she testified about this. Tr. 844-45. As a result, the second quarter of 2009 was the final quarter in which Herbner managed ALC's covenant calculation process. Tr. 845.

2. Third Quarter 2009 to Third Quarter 2010

Sean Schelfout (Schelfout), a non-CPA, was ALC's treasury manager from approximately September 2006 until approximately January 2011. Tr. 967, 1032. Schelfout took over from Herbner as manager of ALC's covenant calculation process for the third quarter of 2009 through the third quarter of 2010. Tr. 970-71, 978-79.

Herbner trained Schelfout on the process in August 2009; the record contains a page of notes Schelfout took during the training. Tr. 970-72; Ex. 141 at 32417. He employed the same process each of the five quarters he managed it. Tr. 1007. Schelfout understood that, after adjustments were made, "you would look at it monthly to try and determine how many employees were required to meet the occupancy requirements." Tr. 974-75. He referred to this process as "backfilling." Tr. 973-74. Although she did not call it that, Bebo understood the backfilling process. Tr. 1997-99.

Schelfout understood that any employee could be included in the calculations, whether or not they visited a Facility, stayed there overnight, or had a reason to go there. Tr. 975. When Schelfout needed the names of employees, he normally requested them of Buono, but assumed that Bebo provided them, "[b]ecause [Bebo] typically [would] make all those kinds of decisions." Tr. 975-77, 999; Ex. 387 at 90587. In one instance he received a list of names that contained Bebo's handwriting. Tr. 1036; Ex. 167 at 11-14 (of 34 pdf pages); *see* Ex. 236 at 94284 (requesting names from Bebo directly); Tr. 1007. Each imputed employee was typically listed for the entirety of each month. Tr. 990. Like Herbner, Schelfout calculated revenue associated with employees before the employees were designated, although Schelfout obtained the rental rate from the "system" rather than directly from Bebo. Tr. 991; *see* Tr. 1201 (the rental rate was "embedded in the spreadsheet"). He then provided the calculation to Buono, who approved the revenue entry prior to Ferreri posting it. Tr. 1021-22, 1041; Ex. 388 at 90715. Schelfout understood that he was to carry over employees from month to month, so that "employees that were in the previous quarters were used to continue to roll into the next quarter." Tr. 1016. However, if an employee was not needed for the covenant calculations, Schelfout asked Buono which individual should be omitted. Tr. 1018.

For the third quarter of 2009, even counting employees, ALC was "[b]arely" passing the financial covenants. Tr. 1006. The number of employees included in the calculations increased substantially over the quarter, from forty-nine in July to sixty-six in August and seventy-six in September. Ex. 20 at 6-9 (of 55 pdf pages). For the fourth quarter of 2009, Houck was listed as an occupant at five different Facilities for each day of that quarter, which gave Schelfout "some concern." Tr. 1014-17; Ex. 22 at 6-8 (of 57 pdf pages).

Like Herbner, Schelfout transmitted the covenant compliance packages to Ventas and did not disclose that ALC employees were used in the covenant calculations. Tr. 1025-27; Exs. 35-40. For at least the final two quarters of 2009, Schelfout requested the names of employees only after the end of the quarter. Exs. 236, 387. While he managed the process, each facility used at least one employee in the covenant calculations, at least sixty-eight different employees were included in the calculations overall, and the quarterly imputed revenue went as high as approximately $773,000 (for the fourth quarter of 2009). Ex. 20 at 6-9 (of 55 pdf pages); Ex. 22 at 5-8 (of 57 pdf pages); Ex. 23 at 6-9 (of 43 pdf pages); Ex. 24 at 6-9 (of 43 pdf pages); Ex. 26 at 6-8 (of 53 pdf pages). For the fourth quarter of 2009, Houck was, as noted, counted at five Facilities simultaneously, six employees (Carlo, Bucholtz, Io Schug, Stacy Cromer, Mike Reed, and Kristen Cherry) were counted at four Facilities simultaneously, and at least ten other employees were counted at multiple Facilities simultaneously. Ex. 22 at 5-8 (of 57 pdf pages). Carter Salvani, Bucholtz's nephew, was counted as an occupant of Greenwood Gardens for the entire quarter, but was eight years old at the time and never actually stayed at a Facility. Tr. 3006-09; Ex. 22 at 5 (of 57 pdf pages).

Schelfout initially believed he would manage the covenant calculations only while Herbner was on maternity leave. Tr. 971. When Herbner resigned, Schelfout began looking for other employment, because the covenant calculation process "didn't feel legitimate," and eventually took the first job he was offered. Tr. 979, 1031. Although Schelfout was aware of some corporate office employees that were actually staying at Facilities, he became uncomfortable no later than his second quarter of managing the process (i.e., the fourth quarter of 2009) because ALC "began having to add quite a few employees to achieve the requirements." Tr. 980; *see* Tr. 984 (Herbner was "aware that [Schelfout] was a little skeptical of the legitimacy of it" as early as August 2009); Ex. 383 at 89017 ("Call me if you have questions or just need to commiserate!"). The designation of Schweer and Nick Welter (Welter), Bebo's husband, added to Schelfout's concern, because Schelfout did not think either was an ALC employee. Tr. 980-81, 997-98; *see* Tr. 2007. Also adding to his concern was the practice of counting employees at multiple facilities for the same time period, because "[y]ou can't be at two places at the same time." Tr. 981-82. His concern was not alleviated after Herbner showed him a copy of Bebo's February 4, 2009, email to Solari, because it did not constitute "legal documentation." Tr. 979, 1077. Schelfout never raised his concerns with Bebo, Buono, or ALC's auditors, because he feared losing his job, and he did not raise his concerns with ALC's Board because he had no direct contact with them. Tr. 984-86, 1027-28, 1074. However, he did keep a copy of the handwritten list of designated employees for the third quarter of 2009, for "protection." Tr. 1001; Ex. 167 at 11-14 (of 34 pdf pages).

3. Fourth Quarter 2010 to Fourth Quarter 2011

Daniel Grochowski (Grochowski), who has been a CPA since 1993, was ALC's director of tax from June 2006 to February 2014, and its director of treasury from January 2011 to February 2014. Tr. 1083-84, 1086-87. At some point prior to January 2011, Grochowski heard office gossip that ALC was "fudging" the covenant calculations by counting employees as occupants. Tr. 1089-90. Grochowski eventually took over from Schelfout as manager of ALC's covenant calculation process when Grochowski became director of treasury in January 2011. Tr. 1090-91.

Schelfout trained Grochowski on the process in January 2011; the record contains a page of notes Grochowski took during the training. Tr. 1092; Ex. 267. Even though Schelfout did not mention it, it was "kind of obvious" to Grochowski that without counting employees in the covenant calculations, ALC "would have not made the covenant calculations." Tr. 1093-94. Schelfout showed Grochowski the spreadsheets Schelfout used to perform the covenant calculations and to "back in" employees to meet the requirements, and explained to Grochowski that the designated employees had to be deleted from the files before they were sent to Ventas, and that the (apparently unadjusted) occupancy data also had to be deleted. Tr. 1094-96. The first time Grochowski sent a package to Ventas, Buono stood over Grochowski's shoulder "making sure that [he] sent the right files to Ventas." Tr. 1096.

Grochowski developed concerns about the process similar to Herbner's and Schelfout's: many listed employees rarely traveled, some employees were listed as occupants of multiple Facilities at the same time, he did not think some listed persons were employees, and, overall, ALC was providing false financial statements to Ventas. Tr. 1097-99. When he raised his concerns with Schelfout, Schelfout said they were a "question for John Buono." Tr. 1101-02. Grochowski asked Buono how ALC was allowed to include employees in covenant calculations, and Buono told Grochowski to read the Lease. Tr. 1102. Grochowski then read the Lease and concluded that nothing in it allowed the practice. Tr. 1101, 1103.

The next month (apparently February 2011), Grochowski told Buono that he had read the Lease and did not see any provision regarding including employees in the covenant calculations, and Buono attempted to allay Grochowski's concerns by promising to increase occupancy "organically." Tr. 1103. Indeed, Grochowski complained to Buono about the covenant calculations nearly every month he was involved. Tr. 1181. Buono eventually told Grochowski that ALC would make the "whole problem" go away by buying the Facilities. Tr. 1105. Grochowski did not initially raise his concerns with Bebo, because he reported to Buono. Tr. 1104.

Grochowski managed the calculation process through the third quarter of 2011. Tr. 1106, 1152; Ex. 30. Although the process was similar to what it was under Schelfout, Grochowski, unlike Herbner and Schelfout, generally refused to perform the "backfilling" calculations. Tr. 1097, 1110-11. Instead, Grochowski calculated how many occupants were gained or lost during a particular month, and Buono calculated how many employees needed to be included in the calculations. Tr. 1109-10. Thus, for April 2011: Grochowski determined that actual occupancy had declined by ten occupants from March 2011; Buono determined that nine employees needed to be added at CaraVita Village and one at Highland Terrace; Buono signed off on the associated journal entry; Bebo and Buono "work[ed] on the names to add during the month"; Bebo provided the names in an email, specifying that all ten were to be added to CaraVita Village; Grochowski entered the names into the spreadsheet; and Grochowski prepared the associated journal entry, which was posted by Ferreri, recording imputed revenue of $180,204. Tr. 1109-17; Ex. 428; *see* Ex. 426 ("We need to do the Cara Vita Allocation (I want to review names)."). Also, because Grochowski "wanted to make it as realistic as possible," if he learned that an employee had left ALC, he crossed out the employee's name on the occupancy recon, so that Bebo and Buono would know to identify more employees. Tr. 1124-25; Ex. 427 at 31711. He was not asked to do this; he simply did it on his own initiative. Tr. 1124-25.

In at least one instance, for the second quarter of 2011, when Buono was not involved in the process, Grochowski did perform the backfilling calculation, and dealt with Bebo directly. Tr. 1129-31; Ex. 433. In October 2011, however, when Buono was again not involved in the process, Grochowski declined to perform the backfilling calculation. Tr. 1133-34; Ex. 302. For that month Bebo did not merely designate employees, she also specified a target coverage ratio. Tr. 1136-37; Ex. 304 ("Laurie told us we need to get it over the .80X.").

Grochowski and Ferreri agreed in November 2011, while Grochowski was working on the November 2011 occupancy recon, that they were both afraid of losing their CPA licenses and did not "want to do this anymore." Tr. 1152. Both had previously approached Wally Levonowich, ALC's controller, who referred them to Buono, who told them that Ventas and ALC's auditors were "aware of it." Tr. 1255-56. When Grochowski and Ferreri approached Buono in November 2011, however, Buono agreed to set up a meeting with Bebo to discuss their concerns. Tr. 1152, 2376. A few days later, Bebo and Buono met with Grochowski and, in a separate meeting, with Ferreri. Tr. 1152-53, 1256. Ferreri agreed to continue posting the journal entries associated with imputed revenue from employees, provided that "Buono prepared the support schedule." Tr. 1256, 1259, 4189-90. Ferreri felt that if he had refused, "it would have been viewed unfavorably and that at some point, my career probably would have ended." Tr. 1261.

When Grochowski met with Bebo, he explained his concerns, including that the covenant calculations did not comply with GAAP. Tr. 1154-56. Bebo said that Fonstad had "given a verbal opinion" that including employees was permissible, but that ALC's outside counsel, Quarles & Brady LLC (Quarles), had not been asked for an opinion. Tr. 1156-57. Bebo also said that Ventas, ALC's Board, and two partners at Grant Thornton LLP (Grant Thornton), ALC's auditor, had approved the practice. Tr. 1157. Grochowski was then shown Bebo's February 4, 2009, email to Solari, which had been "confirmed in a conversation that she and [Buono]" had with Solari. Tr. 1157-59, 1161. The email vindicated Grochowski's concerns, rather than alleviating them. Tr. 1159. Eventually Bebo told Grochowski that he did not "have to be involved in this anymore," and Buono noted that there were no hard feelings, "just more work for [Buono]." Tr. 1162, 2376-77, 4191-92.

Thereafter, Grochowski helped Buono learn the process, but Buono did the calculations himself. Tr. 1162-63. In particular, Buono did the calculations for the fourth quarter of 2011; again, Bebo designated the employees for inclusion. Tr. 2378; Ex. 31 at 7-10 (of 57 pdf pages).

E. ALC's Periodic Reports and Bebo's Certifications

Between May 8, 2009, and March 12, 2012, ALC filed three Forms 10-K and nine Forms 10-Q, representing its periodic quarterly and annual reports for the 2009, 2010, and 2011 fiscal years and for the first three quarters of those years, respectively. Exs. 2-13. The first of these filings, ALC's Form 10-Q for the first quarter of 2009, contained the following paragraph:

> In addition, the failure to meet certain operating and occupancy covenants in the CaraVita operating lease could give the lessor the right to accelerate the lease obligations and terminate our right to operate all or some of those properties. We

> were in compliance with all such covenants as of March 31, 2009, but declining economic conditions could constrain our ability to remain in compliance in the future. Failure to comply with those obligations could result in our being required to make an accelerated payment of the present value of the remaining obligations under the lease through its expiration in March 2015 (approximately $26.8 million as of March 31, 2009), as well as the loss of future revenue and cash flow from the operations of those properties. The acceleration of the remaining obligation and loss of future cash flows from operating those properties could have a material adverse impact on our operations.

Ex. 2 at 30. The same statement, modified to account for quarter-end dates and revised estimates of the remaining obligations under the Lease, appeared in ALC's Forms 10-Q for the second and third quarters of 2009. Ex. 3 at 38; Ex. 4 at 42. Starting with ALC's Form 10-K for fiscal year 2009, filed on March 11, 2010, the paragraph changed slightly but non-substantively, and continued to include the clause "[w]e were in compliance with all such covenants as of" the end of the reporting period. Ex. 5 at 45; Ex. 6 at 34; Ex. 7 at 36; Ex. 8 at 38; Ex. 9 at 45; Ex. 10 at 32.

On July 21, 2011, the Commission's Division of Corporation Finance sent ALC a letter commenting on ALC's periodic filings and requesting answers to certain questions, including one about the likelihood of default on the financial covenants. Ex. 295 at 122835-37. In response, ALC management prepared two alternative responses, one stating that there was a "reasonably likely level of risk of default," and the other stating that there was no "reasonably likely degree of risk of breach." Tr. 2112-13, 2384; Ex. 294 at 122729; Ex. 295 at 122837. ALC's Board approved the more optimistic response in August 2011 – without being told that management had drafted a pessimistic response. Tr. 2112-13, 2384. Thereafter the pertinent paragraph, starting with the Form 10-Q for the second quarter of 2011, filed on August 8, 2011, read:

> However, the failure to meet certain operating and occupancy covenants in the CaraVita operating lease could give the lessor the right to accelerate the lease obligations and terminate our right to operate all or some of those properties. We were in compliance with all such covenants as of June 30, 2011, but continued poor economic conditions could constrain our ability to remain in compliance in the future.
>
> Failure to comply with those obligations could result in our being required to make an accelerated payment of the present value of the remaining obligations under the lease through its expiration in March 2015 (approximately $18.9 million as of June 30, 2011), as well as the loss of future revenue and cash flow from the operations of those properties. The acceleration of the remaining obligation and loss of future cash flows from operating those properties could have a material adverse impact on our operations. Based upon current and reasonably foreseeable events and conditions, ALC does not believe that there is a reasonably likely degree of risk of breach of the CaraVita covenants.

Ex. 11 at 36; *see* Ex. 12 at 36-37 (Form 10-Q for third quarter of 2011); Ex. 13 at 43 (Form 10-K for 2011). As noted, ALC estimated $16.7 million in remaining obligations on the Lease as of December 31, 2011. Ex. 13 at 43.

In each Form 10-Q, Bebo certified that: (1) she had reviewed the Form 10-Q; (2) the Form 10-Q did not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading with respect to the period covered; (3) the Form 10-Q fairly presented in all material respects ALC's financial condition, results of operations, and cash flows as of, and for, the periods presented; and (4) she and Buono had designed or caused to be designed internal controls over financial reporting (ICFR) to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Tr. 1767-68; Exs. 2-4 at Ex. 31.1, 6-8 at Ex. 31.1, 10-12 at Ex. 31.1. Bebo made the same certification in, and also signed, each Form 10-K. Ex. 5 at S-1, Ex. 31.1; Ex. 9 at S-1, Ex. 31.1; Ex. 13 at S-1, Ex. 31.1. As to ICFR, each Form 10-K stated that management had assessed ALC's ICFR under the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Ex. 5 at 51; Ex. 9 at 50; Ex. 13 at 48.

F. Representations to Grant Thornton

Grant Thornton audited all of ALC's annual financial statements, and reviewed all of ALC's quarterly financial statements, from the first quarter of 2009 to the end of 2011. Tr. 3310, 3383; *see* Exs. 5, 9, 13. As a result of each audit, Grant Thornton opined that ALC maintained effective ICFR and that ALC's consolidated financial statements "present[ed] fairly, in all material respects," ALC's financial position, the results of its operations, and its cash flows. Ex. 5 at 52, F-2; Ex. 9 at 51, F-2; Ex. 13 at 49, F-2. For 2009 and 2010 the audit partner, who had ultimate responsibility for ALC's audit, was Melissa Koeppel (Koeppel); for 2011 the audit partner was Jeffery Robinson (Robinson). Tr. 3307-08, 3382. Koeppel and Robinson were the only Grant Thornton personnel with whom Bebo spoke directly about the inclusion of employees in the covenant calculations, although other Grant Thornton employees may have been present during some discussions with Koeppel and Robinson. Tr. 2137-38.

Koeppel understood that Ventas had agreed that ALC could include employees in the covenant calculations if they stayed at the Facilities. Tr. 3366. Koeppel further understood that "employees" included contractors or "representatives" who had a business purpose for being at the Facility, that the employee or representative actually stayed at the Facility, and that ALC was tracking the stays. Tr. 3366, 3373. Her understanding was generally based on discussions with Bebo. Tr. 3366. She also understood that ALC tracked and documented employee stays using reconciliations, compliance reports sent to Ventas, and lists of individuals staying at the Facilities; however, that understanding was based on discussions with Bebo, Buono, and Hokeness, and on reviewing the work done by Grant Thornton's engagement team. Tr. 3375. Bebo told her that the agreement with Ventas was in writing, although Koeppel never saw a written agreement. Tr. 3366. Bebo did not tell Koeppel that ALC was going to include in the covenant calculations former employees, future employees, Bebo's friends and family, or persons who never stayed at the Facilities during the relevant period. Tr. 3367.

Robinson took over responsibility for auditing ALC from Koeppel in early 2011. Tr. 3383-84, 3386-87. Like Koeppel, Robinson understood (until February 2012) that Ventas had agreed that ALC could include employees in the covenant calculations if they stayed at the Facilities for a business purpose, that the "employees" included non-employees doing work for ALC, that the employees actually stayed at Facilities, and that ALC maintained a list of such employees, which it produced to both Grant Thornton and Ventas. Tr. 3388, 3390, 3401-02, 3497, 3502-03. Robinson understood the agreement to be a clarification of the definition of "occupancy" under the Lease. *See* Tr. 3500. Robinson further understood that ALC was reserving, or setting aside, rooms for employees, that the rooms were reserved either before, or right around the time that, the employees traveled to the Facilities, and that the rooms were reserved either before each quarter started or as the quarter progressed. Tr. 3496-97. Robinson, however, gained his understanding by discussions with Grant Thornton's engagement team and with Bebo and Buono, and by reviewing documents. Tr. 3387-88, 3391, 3493-97; Ex. 3528. Robinson did not see Bebo's February 4, 2009, email to Solari until February or March 2012. Tr. 3510-11; Exs. 1824, 1824A. Based on Robinson's understanding, it would not have been appropriate for a family member of an ALC employee, who stayed at a Facility but did not perform work for ALC, to be included in the covenant calculations. Tr. 3498-99. Nor would it have been appropriate for a former or future employee to be included in the covenant calculations, unless they were "actually doing work on behalf of ALC." Tr. 3499.

In connection with Grant Thornton's audit of ALC's 2009 financial statements, Bebo signed a representation letter, dated March 11, 2010, and addressed to Grant Thornton, which stated, "[ALC] has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of a noncompliance." Ex. 64 at 103807. Identical statements appeared in representation letters, also signed by Bebo and dated March 10, 2011, and March 12, 2012, respectively, in connection with Grant Thornton's audits of ALC's 2010 and 2011 financial statements. Ex. 68 at 113641; Ex. 72 at 147870. The representation letter dated March 12, 2012, for the 2011 audit, additionally stated that "[w]e have no knowledge of fraud or suspected fraud affecting [ALC] involving: a. Management [or] b. Employees who have significant roles in internal control." Ex. 72 at 147869. Bebo signed similar letters at the end of each quarter, which stated "[ALC] has complied with all aspects of contractual agreements that would have a material effect on the interim financial [information/statements] in the event of a noncompliance." Ex. 61 at 1520; Ex. 62 at 19924; Ex. 63 at 100256; Ex. 65 at 106173; Ex. 66 at 105597; Ex. 67 at 25380; Ex. 69 at 117435; Ex. 70 at 123325; Ex. 71 at 128511.

G. Expert Testimony

John Barron (Barron), CPA, CFE, the Division's expert witness, received a bachelor's degree in business administration, with a major in accounting, from the University of Florida. Ex. 377 at 2. He worked at Haskins & Sells, a predecessor to Deloitte & Touche (collectively, Deloitte), until 1976, when he took employment at a private real estate investment firm, initially as chief financial officer and later as chief operating officer. *Id.* He rejoined Deloitte in 1987 as a senior audit manager and became a partner in 1990. *Id.* He retired from Deloitte in 2003, after working in both its Atlanta and New York offices. *Id.* While at Deloitte, he served as the engagement partner on numerous audits and interim reviews of Commission-registered entities

and oversaw the auditing services related to several securities registrations and initial public offerings. *Id.* He served as a member of Deloitte's national practice office review team and the accounting industry peer review team. *Id.* In 2003, Barron joined Marks Paneth, an accounting, auditing, tax, and consulting firm. *Id.* He started as a director in its Litigation and Corporate Advisory Services Group, and since April 2014 he has been a senior advisory consultant there. *Id.* While at Marks Paneth, he supervised several audit engagements and provided consulting in technical accounting areas. *Id.* Between 2008 and 2012, he taught undergraduate courses in auditing, financial reporting, and managerial accounting as an adjunct professor at Baruch College in New York City. *Id.* He has provided expert testimony in eight other matters since 2005. *Id.* at 33.

Barron opined on two particularly pertinent issues: whether the financial statements ALC created for the Facilities and forwarded to Ventas were prepared and presented in accordance with GAAP, and the sufficiency of ALC's ICFR. Ex. 377 at 1. As to the first issue, Barron opined that the imputed revenue from employees failed to meet GAAP requirements for revenue recognition. *Id.* at 5. Barron understood, as Herbner testified, that "the employee revenues reported to Ventas would have represented transactions between the [Facilities] and ALC." *Id.* at 28; Tr. 810. Barron observed that the transactions reflected as revenues in the Facilities' income statements did not involve an exchange of cash, and that there was no evidence that the transactions resulted in the Facilities' having a claim to cash. Ex. 377 at 28. He opined that the imputed revenues from employees thus did not qualify as "realized or realizable" within the meaning of the Financial Accounting Standards Board Accounting Standards Codification (FASB Codification) section 605-10-25-1. *Id.* at 27-28 & n.95. Barron further observed that there was no evidence of arrangements setting forth the specific nature and terms of goods or services to be rendered in connection with the imputed revenue from employees, and that there was therefore no evidence that the Facilities had substantially accomplished what they were required to do to be entitled to the benefits represented by the revenues. *Id.* at 28. He opined that the imputed revenues from employees thus did not qualify as "earned" within the meaning of the FASB Codification. *Id.* He explained that: in order to comply with GAAP, the imputed revenues had to be both realized or realizable, and earned; that the imputed revenues failed to satisfy either criteria; and that ALC's inclusion of imputed revenues from employees in the Facilities' financial statements contravened GAAP. *Id.* at 29.

As for ICFR, Barron noted that the COSO framework was based on five components of ICFR, including, broadly speaking, the control environment (which sets the tone of an organization), control activities (including verifications, reconciliations, and segregation of duties), information and communication (including the "clear message from top management that control responsibilities must be taken seriously"), and monitoring (assessing the quality of the system's performance over time, including reporting of deficiencies to management and the board). Ex. 377 at 30-31. Barron contrasted the process for performing covenant calculations, which involved Bebo unilaterally selecting the employees and the number of days they "stayed" at each Facility, with TIPS, which tracked and reported occupants based on data from current resident rosters and residency agreements. *Id.* at 31. Barron opined that there was an absence of internal controls in place to prevent or detect the inclusion of employees without Ventas' approval or agreement. *Id.* at 31-32. Barron also opined, assuming that Ventas had agreed to inclusion of employees in the covenant calculations, that there were "no controls in place that

provided reasonable assurance that the number and names of employee additions were accurate." *Id.* at 31. As examples, Barron observed that there were no controls in place to determine: (1) that the designated employees had stayed or were anticipated to stay at Facilities; (2) whether rooms had actually been set aside for the designated employees; and (3) whether Bebo's selection of employees was appropriate under some other criteria. *Id.* Barron concluded, in a separate analysis, that the potential consequences of default on the covenants were material to ALC's financial statements, and that ALC would have failed the covenants without including employees in the covenant calculations. *Id.* at 32. Accordingly, he opined that "the absence of effective [ICFR] related to the inclusion of employees in the covenant calculations caused ALC to fail to maintain a system of [ICFR] as required by Exchange Act Section 13(b)." *Id.*

Barron also recalculated the coverage ratios and occupancies to determine whether ALC would have met the covenant requirements without including employees. Ex. 377 at 23-27. Barron determined the following. The first covenant requirement (0.8 trailing twelve month coverage ratio per Facility) would have been violated at Winterville every quarter of 2009, 2010, and 2011; and Highland Terrace, Peachtree Estates, and Tara Plantation would have violated that requirement in at least one quarter each during that period. *Id.* at 27. The second covenant requirement (1.0 trailing twelve month coverage ratio for portfolio) would have been violated every quarter from the fourth quarter of 2009 to the fourth quarter of 2011. *Id.* at 27. The third covenant requirement (65% occupancy per Facility) would have been violated every quarter of 2009, 2010, and 2011 by at least one Facility, and seven of the eight Facilities would have violated that requirement at least once during that period. *Id.* at 24-25. The fourth requirement (75% trailing twelve month occupancy per Facility) would have been violated every quarter of 2009, 2010, and 2011 by at least one Facility, and every Facility would have violated that requirement at least once during that period. *Id.* at 25. The fifth requirement (82% trailing twelve month occupancy for portfolio) would have been violated every quarter from the second quarter of 2009 to the fourth quarter of 2011. *Id.* at 25.

Barron and Bebo's experts also opined on other topics, which are discussed *infra*.

III. DISPUTED AND IMMATERIAL ISSUES

The record in this proceeding is voluminous, and the parties dispute a staggering number of facts. Many of the disputed facts, however, are entirely immaterial. The previous section is therefore entitled "Basic Findings of Fact" because it recites those facts which are both material and – with some notable exceptions, addressed *infra* – not disputed. The present section is devoted to explaining how disputes over the Basic Findings of Fact were resolved, making findings as to allegations of the OIP that are not inherently material but that bear upon material issues (particularly scienter), and identifying issues that are immaterial and therefore need not be resolved.

A. Disputed Basic Findings of Fact

The parties do not dispute certain highly relevant facts. Bebo does not dispute that ALC and Ventas entered into the Lease, and although she contends that certain terms of the Lease are ambiguous or immaterial, she does not dispute its contents. Resp. Br. at 46-48. She does not

dispute that she signed ALC's representation letters to Grant Thornton, or the contents of those letters. Tr. 2171. She does not dispute the covenant calculation process, at least in its broad outlines, and in particular she does not dispute that it involved backfilling. Resp. Br. at 99-103. Bebo does, however, dispute several particularly pertinent facts, and the Division did not prove all the allegations of the OIP.

1. The Phone Call and Follow-Up Email

The parties vigorously dispute the January 20, 2009, phone call, the February 4, 2009, follow-up email, and their surrounding circumstances. *See* Div. Br. at 12-15; Resp. Br. at 69-95. The Division contends that the participants on the call discussed, in pertinent part, only a proposal that ALC personnel could stay at Facilities rather than at a hotel, a proposal to which Solari neither agreed nor disagreed. Div. Br. at 12-13. Bebo contends (among other things) that Solari, on Ventas' behalf, agreed that ALC could "set aside apartments for people that have a reason to go [to Facilities]." Resp. Br. at 77-78; Tr. 4003.

a. Documentary Evidence and Percipient Witness Testimony

Solari testified that the call participants discussed whether ALC corporate employees, while traveling to Facilities on business, could stay in vacant units rather than in a hotel. Tr. 414. Solari testified that he did not agree to anything, including that family members and "a limited number or a large number of employees" could be included in covenant calculations. Tr. 420-21. Buono testified that the call participants "discussed the fact that the prior operator had employees staying at [Facilities] and that we desired to do the same." Tr. 2344. Buono further testified that covenants were not discussed, Solari agreed to nothing, and Solari said, in response to what was discussed, "[p]ut your proposal in writing." Tr. 2344-47. Although there is evidence that Fonstad participated on the call, Fonstad did not believe he did and had no notes of it, and thus provided no testimony about what was discussed. Tr. 1504-05, 2343.

However, the most reliable evidence of what the call participants discussed, and any agreements they reached, is the follow-up email. Ex. 184. This is because Bebo read it, sent it, and "didn't have to send it" if she was not "comfortable with the e-mail." Tr. 1934-35. Also, as noted, revisions were made to the original draft submitted to Bebo, demonstrating that Bebo at least agreed to the revisions, and perhaps made the revisions herself. *Compare* Ex. 184, *with* Ex. 1320A; *see* Tr. 1934-35 (the email's content resulted from a "group process"). The email thus documents Bebo's contemporaneous understanding of what had been discussed and agreed to on the call.

The relevant section of the email consists of two sentences. Ex. 184. The original draft stated that ALC was "confirming our notification of our rental of rooms to employees and/or family members," followed by another "notification" stating that the rentals would be in the ordinary course of business on terms equivalent to arms-length transactions, with no mention of covenants, reporting, or agreement on any issue. Ex. 1320A. The final version sent to Solari differed from the original only in that it omitted reference to family members. Ex. 184. The language regarding arms-length transactions is substantively identical to language in Fonstad's January 19, 2009, email and template letter, which language was, in turn, adapted from Section

8.1.3 of the Lease. *Compare* Ex. 184, *with* Ex. 1152 at 259227-28, *and* Ex. 142 at 8720; Tr. 1312-13. Indeed, Buono testified that the original version of the email, which Buono drafted (possibly with Fonstad's help), was taken "directly out of what Mr. Fonstad had written earlier." Tr. 2469.

The two sentences contain language arguably consistent with Bebo's testimony, namely, the use of "rental" and the second sentence in particular: "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." Ex. 184. Bebo argues from this language that "it should have been clear to Ventas that ALC was notifying it of actual employee leasing," and that "ALC was confirming rentals related to employees so they could include them in the covenant calculations." Resp. Br. at 86, 88. Buono testified that his original "assumption" from the January 20, 2009, call was that "there would be no other reason to put [employees] in the [Facilities] other than to put them in the calculations." Tr. 2487-88.

Indeed, if all ALC had wanted was permission from Ventas to house traveling employees in Facilities, with no inclusion of imputed revenue in the covenant calculations, there would have been no need to mention the "terms" of the rentals because there would have been no need for rent. Ex. 184. But the second sentence and the use of the term "rental" are otherwise rather mystifying. No "rentals" actually took place, and even Bebo's account of the call does not explain what was meant by the expression "ordinary course of business." Tr. 4002-06. Certainly the language did not clearly put Ventas on notice that ALC would be including employees in the covenant calculations. And Buono has changed his mind about what the language meant: "Previously my view was . . . that, quite frankly, there would be no other reason to put them in the [Facilities] other than to put them in the calculations, but I can't testify that they agreed to include them in the covenant calculations." Tr. 2487.

Thus, this language could be read as notice that ALC intended to include employees in covenant calculations. *See* Resp. Br. at 86, 88. But the totality of the evidence reveals that Ventas did not view it that way. More to the point, Bebo did not understand it that way, either.

Firstly, Ventas agreed to nothing during the January 20, 2009, call, as confirmed by both Solari and Buono, nor did anyone at Ventas follow up on "rentals" to employees; in fact, there was no further discussion of the topic between ALC and Ventas until 2012. Tr. 414-15, 429, 2344-47, 4074; Ex. 186. Solari testified that the pertinent paragraph of the February 4, 2009, email "confused [him] a little bit" because it "wasn't consistent with [his] general understanding of this topic and what was discussed." Tr. 426-27. He did not respond to ALC when he received the email because he wanted to "transition[]" the matter to Ventas' asset managers, including Doman, and to that end he forwarded the email to Doman and two others at Ventas. Tr. 427-28; Ex. 184. When he found out who at Ventas would follow up, he informed Bebo, and that was the last of his involvement in the matter. Tr. 428; Ex. 186. Doman did not view the February 4, 2009, email as a "formal request . . . under the terms of the lease." Tr. 254. It was his understanding that the Lease did not permit rentals to ALC employees, for the reasons identified by Fonstad, namely, because ALC employees were affiliates and because rentals to employees would not be consistent with the Facilities' primary intended uses. Tr. 212-13. He considered it "the tenant's responsibility to comply with the lease and give us a formal request for things that

they need approved under the terms of the lease," instead of an email stating, in effect, "oh, by the way, just to let you know, this is what I'm doing." Tr. 253-54. Thus, Ventas did not view the pertinent paragraph of the February 4, 2009, email as a memorialization of a modification of the Lease, and its subsequent behavior was consistent with that view.

Secondly, Bebo knew how to articulate ALC's intent clearly, had she desired to do so; the first four paragraphs of the email clearly communicate ALC's intent with respect to the hospice opportunity. Bebo could have used some variant of the language in her first February 19, 2009, email to Solari. Ex. 190 at 12371 ("We . . . propose that the current financial covenants in the lease be replaced . . ."). She could have used the language suggested by Fonstad: "The units would only be considered occupied for purposes of the minimum average occupancy covenants for the days that rent is actually paid." Ex. 1152 at 259228. She could have simply said, as she did in her investigative testimony, that the parties had agreed to waive the financial covenants. Tr. 1945-46. Instead, she used language that came from a section of the Lease entitled "8.1.3 Affiliate Transactions and Payments," and which could thereby be interpreted as simply an acknowledgement that ALC would comply with that section of the Lease, and nothing more. Ex. 142 at 8720; Ex. 184.

Furthermore, Fonstad's email and template letter identified four considerations that did not end up in the final version of Bebo's February 4, 2009, email to Solari. First, Fonstad suggested that "[i]f Ventas agrees to permit employee and relative rentals, the letter we send can be in the nature of a confirmation of our interpretation of the lease," with a signature line for Ventas included. Ex. 1152. The February 4, 2009, email, however, was a unilateral "notification" of ALC's intended actions, not a confirmation of the parties' agreement on interpretation of the Lease, and did not include attachments that Ventas could sign. Ex. 184. Second, the February 4, 2009, email does not mention family members, even though rentals to family members had been discussed at ALC before the January 20, 2009, call, as shown by Fonstad's reference to "relatives of ALC employees" in his template letter. Ex. 1152 at 259228. Third, Fonstad suggested telling Ventas that rentals to employees would be "limited" in number, with a specific number spelled out in the letter, while the email does not propose a limited number. Ex. 184; Ex. 1152 at 259228. Fourth, Fonstad proposed the following sentence in the template letter: "The units would only be considered occupied for purposes of the minimum average occupancy covenants for the days that rent is actually paid." Ex. 1152 at 259228. But covenants are not mentioned in the February 4, 2009, email. Ex. 184. Thus, considering specifically what the February 4, 2009, email omitted compared to what Bebo and Buono knew to discuss with Solari: (1) Solari did not agree to anything on the call, which is why the February 4, 2009, email did not attach a letter with a signature line for Ventas; (2) Bebo at least agreed with (and may have personally made) the decision not to inform Ventas that family members would be included in the covenant calculations; (3) the call participants did not discuss the expected number of employee rentals; and (4) the call participants did not discuss the financial covenants.

Lastly, Bebo continued to pursue covenant modification with Ventas in the weeks immediately following the February 4, 2009, email, which suggests that she viewed the email as an insufficient basis on which to include employees in the covenant calculations. On February 17, 2009, Bebo and Buono proposed purchasing certain properties in New Mexico from Ventas,

"with an amendment to the financial covenants in the Caravita portfolio, namely occupancy and coverage. . . . [and] hinted at eliminating the covenants entirely." Ex. 188 at 12347. The proposal was presented on a call with Solari, who "encouraged them to submit something in writing," as he did with the January 20, 2009, call, but who also told Bebo and Buono "that eliminating the covenants entirely was not likely to occur," and who did not agree to waive the covenants. Tr. 2359; Ex. 188 at 12347.

On February 19, 2009, Bebo sent Solari an email providing more specifics of ALC's proposal, which described details of the covenant "relief" ALC sought, but which omitted any discussion of purchase price. Ex. 190 at 12371. Fonstad either drafted Bebo's February 19, 2009, email, or reviewed and edited it. Tr. 1514; Ex. 189. Solari responded to Bebo later that day, stating that Ventas needed the proposed terms of purchase "before we can respond to your request for providing temporary relief on covenants." Ex. 190 at 12370. About two hours later, Bebo offered $65,000 per unit, with covenant relief only for coverage ratios, not occupancy. *Id.* Buono testified that occupancy coverage relief was omitted because Bebo "felt we had that covered with the employee leasing program." Tr. 2359-60. After another call, Solari countered about a week later with a proposal that was unacceptable to ALC, and the deal was never consummated. Tr. 2360-61; Exs. 191, 195, 196, 198.

In parallel with the Ventas negotiations, and in preparation for ALC's February 23, 2009, Board meeting, Buono sent to Bebo a summary of the anticipated terms of any agreement with Ventas. Ex. 193. However, neither the Board meeting minutes nor the meeting minutes of ALC's audit committee immediately following it specifically mention those terms. Exs. 99, 100. The Board meeting minutes state, in pertinent part, only that "management may seek some relief [from] certain of the covenants in connection with a request from [Ventas] that [ALC] consider the purchase of two unrelated residences" and that "Ms. Bebo distributed financial information regarding the possible acquisition of two residences in New Mexico. . . . The directors . . . directed management to continue discussions as long as [Ventas] is willing to consider meaningful relief under the CaraVita lease covenants." Ex. 100 at 274, 276. The audit committee meeting minutes state nothing about a possible purchase, and only state, as to the financial covenants, that they "were met as of the end of the year." Ex. 99 at 33. Bebo's own testimony on this subject is confusingly self-contradictory. She testified that prior to the February 23, 2009, ALC Board meeting, Hennigar approved the practice of "designating rooms for employee use," a practice that "gave [ALC] a lot of flexibility," and that the Board also approved "the covenant calculations." Tr. 1978-80. Yet just moments later she testified that the Board "would consider the purchase of the New Mexico properties if I was to present any additional meaningful covenant relief," without identifying what "additional meaningful covenant relief" might even be possible. Tr. 1980.

It is not entirely clear when Bebo committed herself to the practice of including non-employees in the covenant calculations, and even if they never visited a Facility, in contrast to the more limited practice ALC employed for the fourth quarter of 2008. No later than February 9, 2009, Buono described the practice to Hokeness as involving only employees who had stayed at Facilities. Tr. 3048, 3125; Ex. 1129. Nonetheless, Bebo would have had no reason to pursue covenant relief of any kind with Ventas, or to mention it to the Board, if the January 20, 2009, call and February 4, 2009, email had already conclusively resolved the issue. Her February 19,

2009, proposal to Ventas was largely about covenants, suggesting that covenant relief was a higher priority even than purchase price, and further suggesting that Bebo did not believe at the time that the January 20, 2009, call had resolved the issue. In sum, her behavior in February 2009 was consistent with that of someone who believed that the issue remained unresolved.

On balance, the pertinent paragraph of the February 4, 2009, email was not documentation of an agreement that employees could be included in the covenant calculations, nor did Bebo contemporaneously view it as such. Thus, the documentary evidence, along with the testimony of the percipient witnesses (save Bebo), present a consistent picture of what was discussed on the January 20, 2009, phone call: Solari agreed to nothing, even that employees could stay at Facilities, and the financial covenants were not discussed at all.

b. Bebo's Account

Bebo's account of the call differs starkly from Buono's and Solari's. *E.g.*, Tr. 4001-11. In summary – which is the only practical way of conveying it, because even Bebo characterizes her testimony on this subject as "extensive[]" – Bebo testified that Solari agreed that ALC could "set aside apartments for people that have a reason to go there," without limitation on the number of such people, and that such "leased apartments can be counted in the covenants." Tr. 4003, 4006, 4010; Resp. Br. at 76.

Principally because Bebo's account of the call is entirely inconsistent with both the documentary evidence and the testimony of the other two percipient witnesses, I do not credit Bebo's account of the call. There are two other significant reasons for discrediting Bebo's testimony on this point. First, her version of events is inherently implausible, both generally and in its particulars. Generally, it is implausible that Bebo would be able to remember the very large number of details she recounted at the hearing, given that six years had passed since the call took place, and three years had passed since she claims to have last seen the notes she took of the call. Tr. 1916, 4011. As one might expect, Solari and Buono in contrast remember few details, but what details they do remember are significant and noteworthy. *See* Tr. 414-16, 2344-47. Bebo's testimony, by contrast, recounts numerous marginally relevant matters, such as that she and Solari discussed the backgrounds of family members and the physical plant requirements for a proposed hospice arrangement. Tr. 4004-05. Indeed, if her memory is so prodigious it is curious that Bebo bothered to take the copious notes she claims to have taken. *See* Resp. Br. at 255-62.

More particularly, certain aspects of Bebo's account just do not ring true. Bebo testified that Solari did not care how many apartments ALC rented for employees and counted in the covenant calculations. Tr. 4003. It is baffling why Solari would ever have said that, thereby effectively waiving the financial covenants; Solari testified that even a request to count employees as occupants would have been "outlandish." Tr. 417. As to a limited or large number of employees included in the covenant calculations, he "would never agree to such a thing, and [] didn't have the authority to agree to it." Tr. 420.

Bebo testified that she initially proposed a rental rate for employees of about fifty percent of the market rate, but that Solari wanted the "full market rate," as if it were an arms-length

transaction. Tr. 4004. This testimony is doubly implausible: Bebo had no incentive to suggest a rate that would make it more difficult to meet the required coverage ratios, by essentially counting employees as half an actual resident, and Solari had no incentive to undermine the financial covenants, by counting employees as if they were actual residents.

Bebo testified that she and Solari discussed "being confident that the people that we would allow to go to the properties would not be a threat to the residents that live there." Tr. 4004. It is puzzling why this topic would have been discussed in the manner Bebo described. Obviously, neither Ventas nor ALC would want ALC employees or their family members to present a threat to Facility residents. ALC employees (although not their family members) routinely visited Facilities as part of their job duties, and nothing in the record suggests that Ventas had ever expressed concern that those employees were a danger to residents. Ex. 3507. It seems much more likely that had the topic actually come up, and had Solari actually agreed to Bebo's proposal, Solari would have insisted on some sort of bond, screening process, or other procedure for ensuring the safety of residents.

Bebo testified that Solari was "comfortable" with including employees in the covenant calculations – in other words, as Bebo testified during the investigation, Solari realized that he was effectively waiving the financial covenants – but that Solari was "not comfortable" with making decisions about ALC's proposed hospice arrangement. Tr. 4003, 4005. However, Solari was responsible for acquisitions, not asset management after an acquisition, and "contact with ALC" after an acquisition "wasn't customary for [his] job." Tr. 399, 409. Solari was the point of contact for ALC because his supervisor "felt it would be a good way to get [him] busy and to establish a relationship with a new tenant," and he had "no authority whatsoever" to modify the terms of the Lease. Tr. 409-10; *see* Tr. 1948 (Bebo: "I don't know that I contemplated [whether Solari had authority to waive the financial covenants] at the time."). There is no reason to think that Solari would have been more comfortable with waiving an entire section of the Lease, which was something definitely not within his remit, than with negotiating a hospice arrangement involving a third party, which was seemingly more consistent with his normal responsibilities, especially as a new employee.

Second, on this point Bebo was generally not a credible witness. I have credited her testimony on other points, and, as noted, she does not dispute numerous facts. Also, her demeanor was in some respects good. She generally possessed a neutral facial expression, and her tone of voice, although unusually lacking in inflection, neither bolstered nor detracted from her believability. But over the course of approximately five full days of testimony, she was successfully impeached over twenty-five times. As to the January 20, 2009, call specifically, she was successfully impeached three times. Tr. 1913-14, 1940-41, 1945-47. In one instance of impeachment, she previously testified that she understood at the time of the call that 564 apartments (i.e., every apartment at every Facility) could be "leased to employees," but testified at the hearing that she "did not contemplate 561 apartments at the time." Tr. 1939-41. In another instance of impeachment, she previously testified that she understood Solari had effectively waived the occupancy covenant, but testified at the hearing that that was not her understanding. Tr. 1945-47. In many instances of impeachment, she attempted to rehabilitate herself by testifying that her prior testimony "doesn't represent my full and complete answer or other answers that I gave within those 50 hours of [prior] testimony," or a similar response. Tr.

1911. Such testimony was not rehabilitating, of course, because it emphasized even more that she gave different answers to the same question.

Her evasiveness and discursiveness throughout the hearing especially damaged her credibility. Although she gave succinct answers in numerous instances, she often pointlessly qualified her responses with "generally speaking," or words to that effect, even to simple questions on undisputed matters. For example, when asked whether she recognized her own Wells submission, she responded, "[g]enerally speaking, yes." Tr. 1867. As another example, after being asked whether Herbner had testified about backfilling, Bebo responded at length and entirely non-responsively. Tr. 4555-57. I then admonished her to be less "long-winded," but my admonishment produced no noticeable improvement. Tr. 4558. I admonished her again several minutes later, and followed up with a simple yes or no question, but even then she responded unnecessarily verbosely. Tr. 4580 (Q: "Do you have an understanding of whether they would be consistent with GAAP, yes or no?" A: "It would be my understanding it is consistent with GAAP."). She was repeatedly evasive under questioning by the Division, especially in contrast to her questioning by her own counsel. For instance, when asked whether she was "involved in ALC's lease negotiations with Ventas," a question to which a simple yes or no would seemingly be appropriate, she repeatedly complained that she did not know what Division counsel meant by the term "negotiations." Tr. 1775-77. When questioned by her own counsel, by contrast, about her role in "the negotiation of that lease," she readily gave a straightforward answer, without needing clarification of the meaning of "negotiation." Tr. 3955.

c. Other Considerations

Overall, therefore, in view of the documentary and testimonial evidence, the inherent implausibility of her account, and her lack of believability on this issue, both generally and specifically, Bebo's version of the January 20, 2009, call with Solari is not credible. I have considered the remainder of the evidence cited by Bebo in support of a contrary conclusion, but I am not persuaded by it.

Bebo argues that Ventas "disregarded" the February 4, 2009, email. Resp. Br. at 85, 87-88. Not so. Doman denied disregarding the email, and testified, in effect, that he did not understand it to be what Bebo now claims it was. Tr. 254. Bebo also notes that "Ventas was in a 'heightened state of alert on the ALC portfolio' with respect to covenant compliance" at the time. Resp. Br. at 85, 88 (citing Tr. 218-19). This is true, but it does not help Bebo, because it supports the allegation in the OIP that Ventas "paid close attention to ALC's compliance" and "considered occupancy and coverage ratio to be key metrics" of the Facilities' performance. OIP at 5. Bebo makes much of the fact that Ventas did not respond to the pertinent portion of the February 4, 2009, email: "any reasonable person in Ventas' shoes would have objected to ALC's confirmation of room rentals related to employees if it did indeed think such a practice would be improper." Resp. Br. at 90. On the contrary, a reasonable person in Ventas' shoes, reading the vague and obscure language of the February 4, 2009, email, in light of the clear requirements of the Lease pertaining to modifications and affiliate transactions, and knowing that ALC continued to seek covenant relief, would have been as confused as Solari and would likely have assumed that ALC would continue to comply with the existing terms of the Lease – which is exactly how Ventas behaved. Bebo argues 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." *Id.* at 91. Not so, as demonstrated by Bebo's own conduct in connection with the negotiations over the New Mexico properties.

Bucholtz, who was not on the January 20, 2009, call, was ALC's director of business development and at the time of the call had become its vice president of sales and marketing. Tr. 2934, 2939-41. Although I have credited other aspects of Bucholtz's testimony, she was generally not a credible witness about the January 20, 2009, call. Her visible and audible demeanor was generally good, but she was impeached eight times in the relatively short time she was on the witness stand. Tr. 2981-82, 2985-87, 2994-95, 3014, 3020-24. She was also sometimes evasive and discursive under examination by the Division. For example, when cross-examined about Fonstad's participation in the January 20, 2009, call, she characterized one of the Division's questions as a "trick question," answered a question with a question moments later, and was impeached shortly thereafter. Tr. 3013-14. She also had reason to shape her testimony to assist Bebo, because she and Bebo are "close friends." Tr. 2979.

Thus, I generally credit Bucholtz's investigative testimony where it is inconsistent with her hearing testimony. Specifically, Bucholtz testified during the investigation that: (1) she could not remember whether Fonstad was a party to the January 20, 2009, call; (2) either Bebo or Buono, but not Fonstad, told her what happened on the call; and (3) she did not speak with Fonstad, or any other ALC attorney, prior to April 2012, about the inclusion of employees in the occupancy determinations. Tr. 2981-82, 2985, 3014. I do not credit her testimony that she, Bebo, Buono, and Fonstad worked together on drafting the February 4, 2009, email. Tr. 2951-53. In addition to her previous testimony she had not talked to Fonstad about the inclusion of employees in occupancy determinations, Buono testified that he drafted the email himself (although with Fonstad "in the room"), Fonstad could not remember even reviewing the email, Bebo testified that only she, Buono, and Fonstad worked on it, and neither the draft nor the final version of the email was sent to Bucholtz. Tr. 1507, 1931-32, 1934-35, 2354; Exs. 184, 1320.

However, I credit Bucholtz's hearing testimony that she reviewed a draft of the February 4, 2009, email at Bebo's request, because she plausibly explained that seeing the draft for the first time in years refreshed her recollection. Tr. 2988. Bucholtz's testimony otherwise sheds little light on the January 20, 2009, call or the follow-up email, although to the extent it is material, it is not always consistent with Bebo's account. For example, Bucholtz testified that Bebo or Buono told her immediately after the January 20, 2009, call that "we were going to be able to count employees in the occupancy." Tr. 2941. But Bebo subsequently sought relief for both occupancy and coverage ratios in a February 17, 2009, call with Solari, which would have been entirely unnecessary had Solari already agreed to include employees as occupants. Ex. 188 at 12347. As another example, Bucholtz testified that she understood from Bebo or Buono, apparently as a result of working on the draft of the February 4, 2009, email, that an employee or family member who "had a reason to go" could "stay" at a Facility. Tr. 2951-53, 3020. But Bebo testified that persons with a reason to go to a Facility need not actually stay there. Tr. 1941-42.

Gale Bebo, Bebo's mother, testified that in April 2012 she saw Bebo's notes of the January 20, 2009, call. Tr. 3271-72. Gale Bebo's recollection of the contents of the notes was

generally consistent with Bebo's account of the call, although Gale Bebo remembered a reference to "employees" rather than "people with a reason to go." Tr. 3274. For three reasons, I do not credit Gale Bebo's testimony on this subject. First, as Bebo's mother she could not have been expected to provide unbiased testimony. Second, her demeanor was very poor: during much of her testimony she slumped in her chair, looked at the ceiling, and sighed before answering questions; she interrupted counsel (both Bebo's counsel and the Division's counsel) in the middle of questions numerous times; sometimes her answers tapered off and became barely audible at the (seeming) end, whereupon counsel began posing the next question, whereupon she roused herself, interrupted the new question, and continued answering the previous question; and many of her answers were non-responsive. *See, e.g.*, Tr. 3283 (when asked whether she had met any of the Division's counsel, she testified that I looked familiar, although she conceded that we had "probably not" ever met). Third, her testimony on certain points was inherently implausible. She testified that: she did not know during the investigation that "anybody was interested" in Bebo's notes of the January 20, 2009, call; the notes were "important" but she did not copy them, and had "no idea" why she did not; and, according to what Bebo told her in April 2012, Bebo could not take the notes home. Tr. 3287-90; *see* Tr. 4492 (Bebo testifying how she gave some notes to her husband).

Bebo argues that Fonstad never advised in his January 19, 2009, email that the "then-contemplated arrangement" would require a formal modification of the Lease, and that the Lease did not require such formality in any event. Resp. Br. at 70-71. Not so. Ex. 142 at 8781-82; Ex. 1152. Fonstad correctly pointed out that by its own terms the "Lease may only be modified by a writing signed by both Landlord and Tenant." Ex. 1152 at 259227; *see* Ex. 142 at 8781-82. He then provided a template for exactly such a writing. Ex. 1152 at 259228. There is no evidence that "ALC and Ventas had reached numerous similar understandings regarding the covenants by e-mail or telephone conversations"; at best, Buono had merely explained to Ventas by e-mail how ALC accounted for its corporate expenses. Resp. Br. at 183; *see also* Resp. Br. at 50-57.

Bebo argues that Fonstad "concluded that having employees stay at the [F]acilities and including employees in the covenant calculations would not violate the primary intended use provisions of the Lease." Resp. Br. at 71. Not so. Ex. 1152 at 259227. Fonstad observed that "Ventas may be willing to agree that limited rentals to employees are consistent with operating the properties as assisted living facilities." *Id.* That is, Fonstad merely noted, in effect, that Ventas might have been willing to permit employee stays notwithstanding each Facility's primary intended use.

Bebo argues that Fonstad "clearly understood that the contemplated employees and family members would not be paying 'rent.'" Resp. Br. at 72. Not so; Fonstad plainly understood that the proposal involved actual payment of rent, even if it was reimbursed by ALC. Ex. 1152 at 259228 ("The units would only be considered occupied for purposes of the minimum average occupancy covenants for the days that rent is actually paid.").

Bebo argues that Fonstad approved Bebo's plan to include employees in the covenant calculations. Resp. Br. at 83. I do not credit Bebo's testimony that Fonstad approved Bebo's plan, or that he changed his advice after the January 20, 2009, call. *E.g.*, Tr. 1936. In addition to all the reasons cited *supra* for Bebo's lack of credibility on this subject, it is unlikely Fonstad

was diligent enough to prepare his January 19, 2009, email, but not diligent enough to document something as momentous as the covenant calculation process eventually implemented. Ex. 1152. At the hearing, Buono recanted his investigative testimony that Fonstad had approved Bebo's plan. *Compare* Tr. 4651-53, *with* Tr. 2381, 4670. Thus, Bebo cannot rely on either a formal advice of counsel defense, or the more general argument that Fonstad's approval mitigates her own misconduct.

Bebo argues that Fonstad "falsely testified that he had no idea one way or another whether the phone call on January 20th ever occurred." Resp. Br. at 92. Admittedly, he should have known of the call and of the follow-up email, because, among other things, Bebo sent him a copy of the email on February 5, 2009, and because Fonstad attended an ALC disclosure committee meeting on February 13, 2009, where the committee discussed "correspondence" between ALC and Ventas "whereby the covenant calculations have been clarified as to census." Ex. 124 at 45435, 45437; Ex. 1171. But on February 18, 2009, Fonstad forwarded to Bebo a draft email to Solari proposing coverage ratio relief in connection with negotiations over Ventas' New Mexico properties, which would have been pointless if he believed that the January 20, 2009, call had resolved the matter. Tr. 1514; Ex. 189; *see also* Tr. 1516-17 (describing covenant relief discussions with Doman on February 25, 2009); Ex. 197. Nor does the documentary evidence otherwise show that Fonstad knew what was discussed on the call. For instance, Hokeness did not send Fonstad a memorandum dated February 9, 2009, describing the covenant calculation process as it was conducted for the fourth quarter of 2008, and I do not credit Bebo's testimony to the contrary. Resp. Br. at 92-93; *see* Tr. 1573 (Fonstad did not receive memorandum); 2484 (Buono did not receive memorandum); Tr. 3052, 3122-23 (Hokeness did not remember circulating memorandum); Ex. 1129; *but see* Tr. 4046-47 (Bebo testified that she received a hardcopy of the memorandum). Thus, even if Fonstad should have known what was discussed on the January 20, 2009, call, I conclude that his lack of recollection of the topic was sincere, as was his testimony that he believed ALC was in compliance with the covenants for the fourth quarter of 2008. Tr. 1580-82; Ex. 1057.

Bebo makes a number of other points about Fonstad's credibility. Resp. Br. at 73-75, 91-95. On the whole, Fonstad was a more credible witness than Bebo. He testified with a good visible and audible demeanor, answered questions straightforwardly and without evasion, and generally remembered matters that one would expect him to remember. To the extent Fonstad testified inconsistently with Bebo on the matters discussed *supra*, I credit his testimony over hers; although I have considered Bebo's many other points on this subject, I do not find them persuasive. Resp. Br. at 73-75, 91-95. In any event, his credibility specifically on the issue of what was discussed during the January 20, 2009, call, and the hotly contested question of whether Fonstad participated in the call, is largely immaterial, because Fonstad remembered nothing about it. *See* Resp. Br. at 73-75; Tr. 3218 (Joy Zaffke testified that Fonstad was in Bebo's office during the January 20, 2009, call).

Bebo also makes a number of points about Solari's credibility. Solari had little memory of the January 20, 2009, call. Tr. 414. He principally testified as to what was not said, based largely on his organizational authority and what he thought he would "never agree to." Tr. 416-23. His credibility is thus of little significance, but inasmuch as it is significant, he testified matter-of-factly, with good visible and audible demeanor, and he had no clear motive to be

biased in favor of either party. I therefore credit his testimony to the extent it is inconsistent with Bebo's.

Bebo contends that Solari had "'apparent' authority to bind Ventas." Resp. Br. at 76, 82. Bebo cites to nothing in the record in support of this contention, and it is inconsistent with Bebo's own testimony. Tr. 1948; Resp. Br. at 76. Bebo argues that Solari's "scripted denials with respect to various aspects of Ms. Bebo's recollection of the call [are] inadmissible and should be given no weight." Resp. Br. at 82. Bebo does not provide any basis for "de-admitting" Solari's testimony, however. *Id.* His denials were repetitive, in that he used the same words multiple times to explain his disagreement with certain elements of Bebo's account, but there is no reason to think those words were "scripted" by the Division. *E.g.*, Tr. 416, 417, 418. Solari admitted that he had previously testified during the investigation that he "couldn't refute Ms. Bebo's account [of] the conversation." Tr. 451-52, 465. But he plausibly explained that at the time of his investigative testimony, he had not been told Bebo's account. Tr. 465-66.

As for Buono, Bebo sometimes relies on Buono's testimony and sometimes disparages it. *Compare* Resp. Br. at 75 (citing Buono's testimony regarding Fonstad), *with* Resp. Br. at 78 (accusing the Division of "craft[ing] his trial testimony"). Concededly, Buono did not give a completely consistent account. For example, Buono testified during the investigation that Fonstad was present on the January 20, 2009, call, and that Fonstad opined that including employees in the covenant calculations was "kosher." Tr. 2343, 4651-53. By contrast, at the hearing – that is, after receiving the investigative file and settling his half of the proceeding – he could not remember Fonstad being on the call, and he testified that he did not discuss including employees in the covenant calculations with Fonstad after the call. Tr. 2347, 2781-82, 4670. Also, Buono was impeached multiple times. *See* Resp. Br. at 9-11.

On the other hand, Buono's many instances of impeachment actually bolstered the credibility of his hearing testimony, both overall and specifically as to the January 20, 2009, call, because his prior testimony tended to be exculpatory and his hearing testimony tended to be inculpatory – which is hardly surprising, in light of his settlement with the Commission. Ex. 458; *see* Resp. Reply Br. at 62-70. The clearest example of this was his admission that he had been mistaken about Ventas. Buono initially believed that "there would be no other reason to put [employees] in the [Facilities] other than to put them in the calculations." Tr. 2487. He testified at the hearing that his initial belief was an "assumption," "opinion," or "interpretation." Tr. 2487-89. Buono eventually came to "believe that maybe this wasn't as good of an agreement as we would have hoped." Tr. 4645. He changed his belief because he did not initially consider that non-employees were included in the covenant calculations, that he and Bebo "never told Joe Solari that we were using them in the covenant calculations," and that ALC "never [sent] covenant calculations" to Ventas. Tr. 2490, 4645. Although there is reason to be skeptical about the sincerity of Buono's initial stated belief, because, among other considerations, it was not consistent with his efforts to obtain covenant relief for ALC in connection with the negotiations over Ventas' New Mexico properties, his current candor enhances his believability. *E.g.*, Ex. 189 (email to Buono outlining covenant relief request). Also, Buono's demeanor was generally good, he was not notably evasive, and, most importantly, his testimony was generally much more plausible than Bebo's. As with Fonstad and Solari, to the extent Buono's testimony is inconsistent with Bebo's on the issue of the January 20, 2009, call, I credit Buono's over Bebo's.

Bebo characterizes as "incredible" Buono's testimony that rental payment for employee apartments, and whether Solari was concerned about such payment, was not discussed with Solari. Resp. Br. at 79. Buono consistently testified to that effect, however, and Bebo's attempted impeachment of Buono on this point failed. Tr. 2344-45, 4656-60. In context, Buono's testimony that it was understood, "based on the January 20, 2009 call," that "the apartment at the [Facility] would be paid directly by ALC" referred to Buono's understanding, not to Solari's. Tr. 4656-57; *see* Resp. Br. at 79.

Bebo contends that Buono believed that ALC and Ventas had "an agreement with respect to how they subsequently proceeded, but that it changed after his numerous meetings with the Division." Resp. Br. at 80. Not so. Buono consistently testified, even during the investigation, that Solari did not explicitly "agree[] to include [employees] in the covenant calculations." Tr. 2487, 2489, 4645. And again, Buono changed his mind about what he assumed Ventas understood after learning more about the case. Tr. 2490, 4645. In particular, Buono changed his mind because he reviewed Solari's "deposition" (i.e., Solari's investigative testimony), which showed that Solari did not agree to include employees in the covenant calculations. Tr. 2490.

Bebo makes much of the fact that Buono's change of mind came after his first interactions with the Division. Tr. 4645; *e.g.*, Resp. Br. at 78 (interaction with the Division "inappropriately colored his memory of the facts, his perception of what understanding ALC reached with Ventas, and the scope of his role in the process"). But there is no evidence that Buono changed his mind as a result of improper conduct by the Division. Indeed, it would have been contrary to the Commission's Rules of Practice if the Division had not provided Buono, while he was still a respondent, with Solari's investigative testimony. *See* 17 C.F.R. § 201.230. There is no evidence that Buono "enter[ed] the SEC's cooperation program"; the document Buono signed before speaking to the Division was merely a proffer letter, not a cooperation agreement. Resp. Br. at 78; Ex. 1976; *see* Tr. 2432 (Buono did not "think that [he] ever entered into the cooperation program"). Nor did the Division act improperly by telling Buono that Bebo had "blamed things on [him]," because her testimony, her Wells submission, and her post-hearing briefs support that representation. Tr. 2435; *compare* Tr. 2347-49 (Buono stating that Bebo directed him to include employees in the covenant calculations, and told him not to tell Ventas that ALC was doing so or to disclose to Ventas what the covenant calculations would be without counting employees), *with* Tr. 4128 (Bebo stating that Buono and Grant Thornton set up the process for determining the number of employees to include in the covenant calculations, a process she "wouldn't be able to explain"); *see* Resp. Br. at 111 (Bebo "relied on Mr. Buono and others" to determine GAAP compliance); Ex. 373 at 34 (same).

Bebo cites several exhibits as "documentary evidence to support" her account. *See* Resp. Br. at 15-18, 20-21. Although some of these exhibits are consistent with other aspects of Bebo's testimony, few of the cited exhibits pertain specifically to the January 20, 2009, call, and those that do are not supportive of Bebo's account. For example, the minutes of ALC's disclosure committee meetings routinely noted "correspondence between ALC and Ventas . . . whereby the covenant calculations have been clarified as to census," or words to that effect. *E.g.*, Ex. 1130A at 198387. However, this language was provided to the committee by Buono, who now believes that Ventas did not have the understanding he said it did. Tr. 1604, 2527-30, 3085, 4645. As another example, ALC's management representation letter dated November 9, 2009, stated that

ALC had "calculated the Caravita lease covenants in accordance with the corresponding lease agreement and as understood by us after conferring with the lessor." Ex. 63 at 100257. Again, though, Buono's understanding has changed. *Id.*

2. Selection of Employees Included in the Covenant Calculations

It is undisputed that, at least after the first quarter of 2009, actual employee stays at Facilities were not tracked at all; indeed, Bebo did not even want to track employee stays. Tr. 4009, 4089. Instead, Bebo generally provided the names of employees to Buono, with instructions to count each listed employee as an occupant for at least one month, and without any instruction to review the listed employees to make sure they were appropriate. Tr. 2350, 2352-53. Bebo believed she had the "institutional knowledge to put down an accurate name on the list," although she now admits she made "errors," that is, sometimes she selected persons who did not satisfy even her fictitious "reason to go" test. Tr. 4098, 4100.

The list of employees to be included in the covenant calculations was left to Bebo's discretion, except to the extent employees were carried over from month to month or stricken by Grochowski. Tr. 1016, 1018, 1124-25; *see* Tr. 4673 (Buono could not remember selecting employees for inclusion). As Buono explained, "[Bebo] was the person to ask, so you know, what she said was accepted as truth from me." Tr. 2352, 4559-60. The employee selection component of the covenant calculation process involved no segregation of duties, no checking of work, and no transparency – in short, no internal controls whatsoever.

The result was that the occupancy and coverage ratio data furnished to Ventas and Grant Thornton, and recorded in ALC's books and records, bore no meaningful relationship to reality. *See generally* Ex. 552A. By way of example, ALC included nine employees in the covenant calculations at various times between 2009 and 2011, none of whom ever stayed at a Facility, all of whom were counted as occupants of at least one Facility for at least one full month at a time, and some of whom were counted as occupants of multiple Facilities at the same time. Tr. 1205-06; Ex. 22 at 5-8 (of 57 pdf pages); Ex. 30 at 9-11 (of 79 pdf pages); Ex. 451 (Linda Abel); Ex. 452 (Bill Bell); Ex. 454 (Amber Brake); Ex. 462 (Sara Hamm); Ex. 466 (Mike Jacksic); Ex. 468 (Joshua Lindsey); Ex. 470 (Rick Parker); Ex. 471 (Mike Reed); Ex. 473 (Io Schug). For the month of September 2011, over forty percent of all occupants included in the covenant calculations for CaraVita Village were employees. Ex. 30 at 9 (of 79 pdf pages). Houck, a senior ALC executive between 2009 and 2011, was counted as an occupant at five Facilities simultaneously for twelve straight months, even though Bebo (to whom he reported) knew that he stayed at hotels because she reviewed his travel reimbursement requests. Tr. 1464-65, 1500; Ex. 22 at 6-8 (of 57 pdf pages); Ex. 23 at 7-9 (of 43 pdf pages); Ex. 25 at 6-8 (of 51 pdf pages); Ex. 26 at 6-8 (of 53 pdf pages). At least two other employees stayed at hotels when they traveled to Facilities. Ex. 2142 at 2 (Linda Abel); Ex. 2143 at 2 (Io Schug). Various non-employee relatives of Bucholtz, as well as Tim Cromer, who was the husband of an ALC employee but not an employee himself, were included in the covenant calculations. Tr. 2054-55, 3006-09; Ex. 22 at 5 (of 57 pdf pages); Ex. 26 at 6-8 (of 53 pdf pages). Welter, Bebo's husband, took photos of Facilities "pro bono" in approximately 2009, stayed at two Facilities for one night each, and was never an ALC employee, but was included in the covenant calculations of two Facilities for the

entirety of at least two quarters. Tr. 2007, 2011; Ex. 22 at 5, 7 (of 57 pdf pages); Ex. 26 at 6-7 (of 53 pdf pages); Ex. 495 at 49-51, 61.

Bebo correctly points out that some employees included in the covenant calculations traveled to or stayed at Facilities between 2009 and 2011. Ex. 3507; Resp. Br. at 107-08; *e.g.*, Ex. 460 (Stacy Cromer stayed at multiple Facilities in 2010 and 2011). Nonetheless, Bebo's selection of employees to include in the covenant calculations was essentially arbitrary. It was also unilateral, that is, it was not meaningfully reviewed by anyone else. Grant Thornton did not opine on whether the individual Facilities' financial statements were prepared in accordance with GAAP, and did not scrutinize them beyond "compar[ing] [ALC's] occupancy report to the numbers." Tr. 3365; Ex. 1374. Regrettably, Grant Thornton's audit work focused more on the consolidated financial statements, and less on "the process leading up to that point." Tr. 3347-48, 3365. I do not credit Bebo's testimony that Grant Thornton twice found "somebody who was on the list but was no longer an employee." Tr. 4092, 4096; *see* Resp. Br. at 103. Grant Thornton did not scrutinize ALC's materials to that level of detail, no documents corroborate Bebo's testimony, and Buono – who, according to Bebo, brought Grant Thornton's findings to her attention – also did not corroborate Bebo's testimony. Tr. 2520.

As for internal ALC personnel, Bebo's position as CEO made it difficult, to say the least, for her subordinates to "review" which employees were included in the covenant calculations. Buono routinely complained to Bebo about keeping the covenant calculation process "real," and at least once pointed out to her that he did not "look good in stripes." Tr. 2365. Otherwise, no ALC employee directly challenged Bebo on the covenant calculation process for almost three years. Instead, those employees who participated in the process started looking for other employment (as with Herbner and Schelfout), made the process more difficult by deleting employee names (as with Grochowski), or made the process more difficult by asserting (with little basis) that federal law required Bebo and Buono to authorize journal entries (as with Ferreri). Those who did not participate in the process had no reason to "review" anything, and in any event they had been told that Ventas had approved it. *See* Tr. 3123 (Hokeness), 3728 (Lucey).

In sum, the employees included in the covenant calculation process were not "reviewed by multiple employees internally and by [ALC's] external auditors" in any meaningful way. Resp. Br. at 109. Nor were there any "[c]hecks and balances between [Bebo] and the financial office within ALC." Resp. Br. at 106. Neither Grant Thornton nor Ventas had any understanding that Bebo unilaterally selected employees to be included in the covenant calculation process. Tr. 2091-92, 2128-31, 2150-51, 2164; Ex. 1685 at 5 (of 6 pdf pages) ("extra rooms . . . are set aside for ALC employees"). Even Facilities managers were unaware that units had been "occupied" by employees. Tr. 2071-72.

3. Representations to Grant Thornton

As noted, the January 20, 2009, call did not effect a modification of ALC's Lease with Ventas, ALC was therefore contractually obligated to meet the Lease's covenants, and ALC did not do so. Bebo does not dispute that she repeatedly stated in representation letters to Grant Thornton that ALC had "'complied with all aspects of contractual agreements that would have a

material effect on the financial statements in the event of a noncompliance.'" OIP at 9; Tr. 2171. Assuming that noncompliance with covenants would have had a material effect on ALC's financial statements, an issue addressed *infra*, it follows that Bebo repeatedly made false representations to Grant Thornton in connection with financial statement audits and reviews. Bebo contends that "Grant Thornton was aware of the employee leasing program from the outset," a fact the Division disputes. Resp. Br. at 133; Div. Br. at 38-39. Whether Grant Thornton was fully apprised of the covenant calculation process is material because, at a minimum, it bears on scienter.

Bebo misled Grant Thornton about ALC's covenant calculation process. This subject is better documented than the January 20, 2009, call and its follow-up email, and the documentary evidence, particularly once Robinson took over from Koeppel, clearly shows that Grant Thornton did not possess a complete picture of the covenant calculation process. Koeppel testified that she understood Ventas had agreed that ALC could include employees in the covenant calculations if they stayed at the Facilities, that "employees" included contractors or "representatives" who had a business purpose for being at the Facility, and that ALC was tracking and documenting the stays. Tr. 3366, 3373. Koeppel's understanding was based at least in part on discussions with Bebo, who did not tell Koeppel that ALC was going to include in the covenant calculations former employees, future employees, Bebo's friends and family, or persons that never stayed at the Facilities during the relevant period. Tr. 3366-67. According to Koeppel, Bebo told her that there was "a written agreement between the parties," which was "much more important . . . than simply a documentation of a conversation." Tr. 3328.

Robinson's understanding of the covenant calculation process was similar to Koeppel's, and was gained in part via conversations with Bebo about it. Tr. 3388, 3390, 3393, 3401-02, 3496-97, 3502-03. Robinson documented his understanding in an email dated April 21, 2011: "[Buono] indicated that there was an exchange of letters allowing the company to use employees to meet the covenants." Ex. 3528. That same day, Robinson received from an audit team member a copy of the Lease, which he read to confirm that it contained no "substantial definition of occupancy." Tr. 3395-96; Ex. 1795. Robinson did not understand that the covenant calculation process involved "just figuring out how many rooms they needed to meet the covenant calculations after the fact," rather than reserving rooms ahead of time. Tr. 3497.

The audit team's understanding was documented in Grant Thornton's work papers, at least in part. Ex. 1685 at 5 (of 6 pdf pages); Ex. 1696 at 1-2 (of 10 pdf pages). The work papers characterize the process as involving rooms "set aside for ALC employees to improve the overall performance of each [F]acility." Ex. 1685 at 5 (of 6 pdf pages). The work papers note that "[e]ach quarter [ALC] sends Ventas this detailed occupancy spreadsheet which displays all adjustments being made to occupancy on a monthly basis." *Id.* Herbner forwarded a copy of the February 4, 2009, email between Bebo and Solari to the Grant Thornton audit team (but not directly to Koeppel) on May 5, 2009. Tr. 869-70; Ex. 3053. The audit team inquired later that day whether there was "any further correspondence on the issue," and Herbner, on behalf of Buono, informed them that "no further correspondence [was] required," which apparently satisfied the audit team at the time. Tr. 870-71; Ex. 3054. Because Ventas apparently had "the opportunity to disagree with the calculation and adjustments being made," and had not "openly

disagreed with the calculation," Grant Thornton considered the adjustments reasonable. Ex. 1685 at 5 (of 6 pdf pages).

Each quarter ALC forwarded to Grant Thornton the list of employees who had been included in the covenant calculations. Tr. 3341-42; *e.g.*, Ex. 3076 at 5-8 (of 59 pdf pages). Grant Thornton eventually learned, on approximately February 20, 2012, that ALC was not sending the same list of employees to Ventas. Tr. 3406-07, 3414; Ex. 3341. At least some audit team members "kind of expected" this. Ex. 3342. On March 5, 2012, Grant Thornton again received a copy of the February 4, 2009, email between Bebo and Solari. Tr. 3419-20; Exs. 1824, 1824A. Grant Thornton then concluded that the February 4, 2009, email, in combination with management's representations since 2009 and the fact that the covenants had been so calculated for years, was "adequate documentation." Tr. 3421-22; Ex. 1696 at 7-8 (of 10 pdf pages). Astonishingly, Grant Thornton did not believe it was necessary to ask Ventas about any agreement with ALC regarding covenant calculations. Tr. 3523.

Thus, the pertinent documentary and testimonial evidence is almost entirely consistent, and demonstrates that Grant Thornton did not know the full scope of ALC's covenant calculation process. The exception is Grant Thornton's decision to issue an unqualified opinion as to ALC's 2011 audit – a decision that was both self-serving and based on still-incomplete information about the covenant calculation process. Also, although Robinson was sometimes evasive and non-responsive, particularly under examination by the Division, he and Koeppel otherwise testified straightforwardly and with a good demeanor. *E.g.*, Tr. 3505-10. A third Grant Thornton audit partner, James Trouba, also possessed a good demeanor and testified consistently with Koeppel and Robinson. Tr. 3590-92. I therefore credit their testimony on this subject, and conclude that Bebo misled both Koeppel and Robinson, and more generally Grant Thornton, by mischaracterizing ALC's covenant calculation process.

Bebo's arguments on this point are not persuasive. First and foremost, Bebo concedes that she did not personally disclose the full scope of ALC's covenant calculation process. She "never specifically" told Koeppel that ALC was including in covenant calculations non-employee residents and persons who did not actually go to Facilities. Tr. 2150-51. Nor did she personally tell Koeppel that her friends and family members, and Bucholtz's family members, were included in the covenant calculations. Tr. 2151-54. She did not "specifically say" to Robinson that "ALC had been including employees in the covenant calculations that hadn't visited the properties," at least initially. Tr. 2164.

Bebo testified that she told both Koeppel and Robinson that ALC and Ventas had agreed that "people that have a reason to go" could be included in the covenant calculations. Tr. 2150, 2167-68. She also testified that, "[g]enerally speaking," she explained to Robinson at a Board meeting in August 2011 that "people who weren't going were being included in the covenant calculations," and testified during the investigation that she told Robinson that "a non-resident could be used in the covenant calculations for multiple properties over the same time period." Tr. 2168-69. There is no evidence to corroborate this testimony, and I do not credit it.

Bebo contends that Buono "confirm[ed]" that "employee leasing" was discussed at the August 2011 audit committee meeting, which Robinson attended. Resp. Br. at 129; *see* Ex. 115

at 100-02. This is literally true, but sheds no light on the issue. At the hearing Buono remembered that "employee leasing" was discussed, but could not remember any specifics, and in particular he did not remember "the specifics of talking about it being used in covenant calculations." Tr. 4632; Ex. 2122 at 112.

Bebo argues that Grant Thornton "was aware of the employee leasing program from the outset," and "ALC never withheld any information from Grant Thornton." Resp. Br. at 133-35. Not so. Grant Thornton understood until early 2012 that persons employed by or representing ALC, and who actually stayed at Facilities, were included in covenant calculations, and that the evidential material supporting the covenant calculations was being sent to both Grant Thornton and Ventas. This understanding was based in part on oral representations from Bebo and other ALC personnel. That Grant Thornton did not actually discover ALC's deception for three years, and then self-servingly opined that ALC had no material deficiencies in its 2011 (and subsequent) financial statements, does not change the fact that Bebo and ALC did, in fact, deceive Grant Thornton. Resp. Br. at 135; Resp. Reply Br. at 92-93; Ex. 13 at F-2.

Bebo argues that Grant Thornton did not find "troublesome" the fact that ALC's employee lists included the same employees at multiple locations for the same quarter. Resp. Br. at 136; *see* Resp. Reply Br. at 93. Not so; in fact, Robinson was notably non-responsive when asked about this. Tr. 3404. And it is irrelevant that Grant Thornton understood that employees were not paying rent and that the imputed revenue from employees was eliminated via the 997 account, because those features of the covenant calculation process were consistent with Bebo's representations about the process. *See* Resp. Br. at 136.

Under the totality of the circumstances, therefore, Bebo misled Grant Thornton about ALC's covenant calculation process.

However, she did not mislead Grant Thornton regarding Grochowski and his complaints. In November 2011 Grochowski told Bebo of his "concerns" about the covenant calculation process. Tr. 1154-57. Thereafter, in ALC's representation letter to Grant Thornton for the 2011, Bebo signed a statement that ALC had "no knowledge of any allegations of fraud or suspected fraud affecting [ALC] received in communications from employees." Tr. 2172-73; Ex. 72 at 147869. The Division contends that Bebo's representation to Grant Thornton was false or misleading in light of her November 2011 discussion with Grochowski. Div. Br. at 54; *see* OIP at 10.

This contention is unproven, because the evidence shows that Grochowski's expression of concern to Bebo was not an allegation of fraud or suspected fraud. Subjectively, Grochowski thought the covenant calculation process was a "sham." Ex. 353. But Grochowski admitted that he did not specifically allege "fraud" when he met with Bebo in November 2011. Tr. 1191. Nor would one expect him to; accusing the CEO and CFO of one's company of fraud, to their faces, is a career-ending action. Even in his whistleblower letter (discussed further *infra*) Grochowski characterized part of the covenant calculation process as a "sham," but he did not use the term "fraud." Exs. 353, 1132. The consequence of Grochowski's circumspection was that Bebo could accurately (if somewhat disingenuously) represent to Grant Thornton that she did not know of any allegations of fraud or suspected fraud at the time.

4. Ventas' Scrutiny of ALC's Covenant Compliance Reports

The OIP alleges that "Ventas reviewed and scrutinized the financial covenant calculations, quarterly financial statements and other information which accompanied ALC's officer certificates." OIP at 5. The most important allegation in this proceeding is that ALC falsely asserted covenant compliance in its periodic filings. OIP at 8-9. Whether Ventas reviewed and scrutinized ALC's quarterly reports has no bearing on that allegation. However, any scrutiny by Ventas arguably bears on the materiality of any false statements in ALC's periodic filings.

Every percipient witness except Bebo testified that the covenants were important to Ventas. Resp. Br. at 61-64. Solari testified that Ventas "cared very much" about whether ALC satisfied the Lease covenants because it "was a way to measure the performance of the [Facilities]," and the "better they performed, the more they would be valued." Tr. 401, 404-05. According to Doman, Ventas cared about ALC's covenant compliance because it had a "fiduciary responsibility" to ensure that a Facility maintained its value. Tr. 382. Joy Butora (Butora), an asset manager at Ventas who reported to Doman and tracked ALC's covenant compliance, explained Ventas' process for reviewing ALC's reports. Tr. 892-95. She also explained that although receiving rent was one of her important responsibilities, occupancy was also important to Ventas because it was "an indicator of the profitability of that particular community," and that the financial statements required of ALC needed to comply with GAAP because "otherwise, you could just make up what you wanted." Tr. 896, 909, 936. Buono testified that Ventas' top two priorities were receiving rent and "having properties in good condition and running well." Tr. 4655-56; *see* Ex. 301 (agenda for ALC-Ventas call in third quarter of 2011); Ex. 308 (same for fourth quarter of 2011). Even Bebo agreed that Ventas held quarterly calls, inquired about occupancy, and visited Facilities. Tr. 2098-99, 4148-49; Exs. 212, 262.

Bebo nonetheless contends that "the occupancy and coverage ratio covenants were of little importance" to Ventas. Resp. Br. at 61-64. Oddly, Bebo spends several pages of her opening post-hearing brief summarizing evidence that refutes her contention. *See* Resp. Br. at 50-57. In any event, the evidence Bebo marshals in support of this contention is unpersuasive. Neither Doman nor Bebo could remember any instance where a landlord pursued a default solely for a financial covenant violation, but this is beside the point, because ALC did not merely violate the covenants, it affirmatively misled Ventas. Tr. 379-81, 4050-51. Bebo testified that "the idea that Ventas cares about financial covenants, in and of itself, I think, doesn't make any sense," and that the covenants only aid in determining if there is "a problem with the tenant paying the rent." Tr. 4048. This is another example of Bebo's inherently implausible testimony. As Solari, Doman, and Butora all explained, Ventas owned the Facilities and, quite reasonably, wanted them to be run profitably so that they maintained their value, not merely so that their cash flow would cover the rent. *E.g.*, Tr. 382. Buono's testimony, that Ventas' second priority after receiving rent was to ensure the Facilities were in good condition and running well, was generally consistent with the Ventas employees' testimony. Tr. 4655-56; *see* Ex. 2069 at 5-6 (of 16 pdf pages) (touting covenant protections that "Enhance Rent Reliability"). Butora admitted that she did not specifically tell anyone at ALC that "these covenants were really important to Ventas," but there would have been no reason for her to, because the covenants were written into

the Lease. Tr. 950-51. That Ventas took some action when it learned of problems with the Facilities, but not the most drastic action available, is not evidence that the covenants were of little importance to Ventas. *See generally* Resp. Br. at 63-64. Bebo herself made the decision to bar Ventas from visiting one Facility in December 2010 because she was "overly concerned" about its low actual occupancy, thereby preventing Ventas from learning what she claimed Ventas did not care about. Tr. 2099-2100; Ex. 262.

But the overriding reason to reject Bebo's contention is that when Ventas learned that ALC had included employees in the covenant calculations, it moved to amend its pending complaint to add a claim for violation of the Lease's reporting requirements. *See* Ex. 2075 at 1-2; Ex. 2076 at 1-2. By way of background, in February and April 2012, ALC received notices of intent to revoke the operating licenses of three Facilities. *See generally* Exs. 333, 2061A. ALC notified Ventas as required by the Lease, and Ventas filed a declaratory judgment action against ALC on April 26, 2012, for breach of contract. Ex. 1194 at 2018-19; Ex. 2075 at 1. On April 27, 2012, ALC proposed a settlement to Ventas which would have included a release of claims "based upon [ALC] renting rooms on the [Facilities] to certain of its employees and including those employees in certificates and covenant calculations." Tr. 613, 2226; Ex. 350 at 151598. Bebo resisted putting that language in the proposed settlement agreement, and solicited a letter from Quarles advising against using the language by misleading Quarles about Ventas' knowledge of the covenant calculation process. Tr. 613; Ex. 1068A; *see* Resp. Br. at 147. The language notified Ventas, for the first time, that employees had been included in the covenant calculations. Tr. 246-49.

On May 3, 2012, after receiving Grochowski's whistleblower letter, ALC's Board determined to investigate the covenant calculation process, and disclosed that fact, which ALC tersely characterized as "possible irregularities in connection with" the Lease, in a Form 8-K filed May 4, 2012. Tr. 616; Ex. 2075 at 1-2. On May 9, 2012, Ventas sent ALC a default notice which alleged that ALC had not complied with Section 25 of the Lease, which pertained to, among other things, GAAP-compliant books and records, delivery of annual and quarterly financial statements, and Officer's Certificates. Ex. 142 at 8766-67; Ex. 355 at 154444. The default notice also alleged that ALC had "submitted fraudulent information" and may have "fail[ed] to maintain required occupancy and coverage ratios" by "treating units leased to employees as bona fide rentals by third parties." Ex. 355 at 154443. On May 10, 2012, Ventas filed a motion to amend its complaint to add a claim for violation of Section 25 of the Lease. Ex. 1194 at 1674; Ex. 2076 at 2. On May 15, 2012, Ventas moved for expedited discovery, and explained that ALC had "failed to provide Ventas with any details regarding the scope or subject matter of [the Board's] investigation or the irregularities concerning the Ventas lease." Ex. 357 at 3. Ultimately, the action was settled in June 2012 by ALC purchasing the Facilities, and four other Ventas-owned senior living centers, for $100 million. Ex. 2077 at 2. Of the $100 million purchase price, approximately $37 million was treated for accounting purposes as a "lease termination and settlement fee." Ex. 2078 at 10-11; Ex. 3369 at 397735.

Ventas' proposed amended complaint did not expressly include a claim for violation of the covenants. Ex. 1194 at 1674. But the claim for failure to comply with the "reporting obligations under Section 25" of the Lease was understood at the time by both Ventas and ALC as a reference to covenant non-compliance. *See* Tr. 247 (Doman testified that "we responded

with a lawsuit"); Tr. 617-19 (Bell testified that before the May 9, 2010, default notice, Ventas' complaint had only "alleged the breach of the lease because of the notices of revocation"); Ex. 3369 at 397734 (ALC internal memorandum, shared with Grant Thornton, stating that "Ventas claimed ALC was in default on several counts including occupancy below covenant requirements"). Ventas' plain intent, as understood at the time by ALC and as ALC incorporated into its settlement deliberations, was to seek monetary and injunctive relief (as opposed to mere declaratory relief) for including employees in the covenant calculations, among other considerations. Bebo's contention that Ventas did not "bring claims against ALC for unit rentals related to employees" is meritless. Resp. Br. at 147; Resp. Reply Br. at 14-17.

5. Disclosures to ALC's Board

The OIP alleges that by the first quarter of 2009 ALC had violated the financial covenants, that "rather than report the defaults to . . . ALC's [Board] . . . Bebo directed Buono and his staff to include employees and other non-residents in the financial covenant calculations," and that at each Board meeting in 2009, 2010, and 2011 Bebo and Buono "reported that ALC was in compliance with the covenants." OIP at 5. These few statements in the OIP resulted in an avalanche of evidence pertaining to what Bebo, Buono, and others disclosed to the Board and when. *See generally* Resp. Br. at 120-33; Resp. Reply Br. at 9-14.

Most issues relating to Bebo's communications and interactions with the Board, and with the Board's deliberations and votes, are immaterial. As the Division correctly notes, "someone who participates in a fraudulent scheme by following his superior's instructions to carry out fraudulent acts can be liable as a primary violator under Section 10(b) and Rule 10b-5." Div. Br. at 51 n.25 (quoting *Robert W. Armstrong, III*, 58 S.E.C. 542, 563 (2005)). Even if the Board approved the covenant calculation process, as Bebo contends, she can still be held liable, and any such approval is therefore generally immaterial. *E.g.*, Resp. Br. at 95-99; Resp. Reply Br. at 9-12. Nor does the Board's 2012 handling of the Lease's breach, reporting of the breach of the Lease's financial covenants in periodic filings, or decision not to file a restatement of ALC's financial statements have any relevance, because Bebo had little to do with them. *See generally* Resp. Br. at 147-61, 205-06 (summarizing events post-dating May 3, 2012). There are two exceptions, both bearing on scienter: Bebo's efforts to sell ALC in late 2011 and early 2012, and the degree to which the Board understood the covenant calculation process at different times.

The first issue is relatively straightforward. In mid-2011, Hennigar wanted to explore the possibility of selling ALC. Tr. 2371-72, 4324. Bebo started working especially long hours to grapple with the added responsibility, Rhinelander was appointed the chair of the committee overseeing the sale process, and ALC hired Citibank for investment banking services. Tr. 2829, 2903, 3838; Ex. 1595 at 245178. On July 27, 2011, Bebo sent Citibank a "Facility Lease Summary," which described the Lease covenants, and she stated in the cover email that she and Rhinelander "do not want the individual facility listing and occupancy sent to Ventas at this time." Ex. 287 at 121071, 121096. The next day, July 28, 2011, Bebo sent Citibank a list of ALC's facilities and their occupancy, including Facility occupancies that did not include employees in the occupancy calculation, and she again singled out Ventas: "do not release [occupancy] to Ventas without [Rhinelander's] specific permission." Ex. 292 at 121196; *compare* Ex. 292 at 121199, 121201(listing Facility occupancy as of July 12, 2011), *with* Ex. 29

at 7 (of 67 pdf pages) (listing Facility occupancy as of the second quarter of 2011, as transmitted to Grant Thornton). Although Rhinelander had the ultimate say in whether to release occupancy numbers to Ventas, he initially concurred with Bebo's directive to Citibank not to release occupancy data to Ventas, but, significantly, he did not review the occupancy numbers. Tr. 2905, 2908-10, 2914-15.

ALC also set up an electronic data room in which prospective buyers could conduct due diligence. Tr. 2116, 2903. Buono believed that any prospective buyer would "struggle" with "recogniz[ing]" the existence of an agreement with Ventas to include employees in the covenant calculations, and told Bebo that buyers would want to know the purpose of the 997 account. Tr. 2373. Bebo, too, was concerned that prospective buyers would not think that her February 4, 2009, email to Solari "adequately set forth" that ALC would satisfy the occupancy covenants by "employee leasing." Tr. 2129-34. In fact, one bidder did eventually inquire about the 997 account, which by that point Bebo characterized as a "$2 million receivable." Tr. 2724, 4435.

Grant Thornton learned on or about February 20, 2012, that ALC had not been sending Ventas the same lists of employees included in the covenant calculations that ALC had sent Grant Thornton. Ex. 3342. No later than February 21, 2012, ALC received a notice of intent to revoke the license of one of the Facilities from the state of Georgia. Ex. 1194 at 1866; Ex. 2061A. ALC notified Ventas by letter dated March 2, 2012, and signed by Buono. Ex. 1194 at 1881-82. On March 5, 2012, Buono emailed a copy of Bebo's February 4, 2009, email to Solari to Grant Thornton, at Grant Thornton's request. Tr. 3418-19; Exs. 1824, 1824A. That is, no later than March 5, 2012, Ventas knew that ALC was in breach of the Lease as to at least one Facility, Grant Thornton knew that ALC's covenant compliance required further scrutiny, and Buono was aware of Ventas' and Grant Thornton's knowledge.

To address these issues Bebo and Buono discussed the possibility of ALC purchasing the Facilities. Tr. 2373-74. Buono drafted a proposal on March 5, 2012, and showed it to Bebo, who showed it to Rhinelander, who told Bebo to share it with Hennigar. Tr. 2388; Ex. 317; Ex. 492A at 135-37. The proposal itself did not mention the covenant calculation process, and Rhinelander testified that he did not know that employees were included in the covenant calculations until the evening of March 6, 2012. Tr. 2837. However, when Buono presented the proposal to Hennigar on the morning of March 6, 2012, prior to that day's scheduled meeting of ALC's Compensation/Nomination/Governance (CNG) committee, Buono told Hennigar that ALC was "in default, potentially under the agreement, on the occupancy," and that a prospective buyer of ALC had inquired about the 997 account. Ex. 492A at 137; *see* Tr. 580, 2388; Ex. 121 at 56239. The CNG committee convened that morning, with Hennigar, Bell, and Buntain in attendance, and Buono was called in to describe "the manner and approach of [ALC] in connection with its performance in respect of certain covenants in the Ventas lease," as well as to discuss his proposal for purchase of the Facilities. Ex. 121 at 56239; Tr. 2776-77.

After Buono left the meeting, the CNG committee called in Bebo. Ex. 121 at 56239. According to the meeting minutes,

> [Bebo] advised that the inclusion of [ALC] employees for the covenant tests had been agreed to by Ventas and it had been confirmed in writing with Ventas. In

> addition, [Bebo] stated there was a legal opinion of Eric Fonstad which confirmed that [ALC]'s inclusion of its employees for the purposes of the Ventas lease covenants was acceptable.

Id. As noted, neither of these statements was true. Nor was Bebo's explanation fulsome, because the covenant calculation process involved much more than merely including employees in the calculations. Thereafter, according to both Bebo and Buono, the Board acted as if it "were suffering from amnesia regarding the inclusion of employee occupants in the covenant calculations." Tr. 2777-78, 4456.

More importantly, the Board essentially took matters out of Bebo's hands. *See generally* Resp. Br. at 147-61, 205-06. The Board became less communicative with Bebo, and ultimately terminated her on May 29, 2012, although it continued to employ Buono. Tr. 621-22, 2767-68. After her termination Bebo filed whistleblower complaints against ALC with the Commission and the Occupational Safety and Health Administration, as well as an arbitration that resulted in ALC issuing a letter characterizing her termination as a voluntary resignation. Tr. 2162, 4493-94; Exs. 1173 (under seal),[5] 2067. Otherwise, Board-related and sale-related events post-dating the March 6, 2012, CNG committee meeting have little bearing on scienter.

Bebo raises a number of points pertaining to ALC's sale and proposed sale, none of which are persuasive. Bebo contends that she had an innocent reason for treating Ventas differently from other prospective buyers of ALC, namely, that Ventas was a direct competitor of ALC. *See Id.* at 139-40. But she also had a venal reason, which she admitted during her investigative testimony was a concern: Ventas had been receiving data inconsistent with the due diligence materials for three years. Tr. 2120-23, 2126. Bebo contends that it was Rhinelander's decision not to disclose occupancy data to Ventas. Resp. Br. at 140-41. This is true, but does not help her, because Rhinelander simply went along with Bebo's recommendation, which seemed reasonable to him at the time. Tr. 2905, 2911, 2914-15. Bebo contends that she wanted to be forthcoming to prospective buyers about the covenant calculation process, and about the 997 account in particular. Resp. Br. at 141-42. Not so. Bebo's proposed disclosure to prospective buyers included a reference to the February 4, 2009, email to Solari, which at least one Board member believed, correctly, was inadequate justification for the covenant calculation process, and the disclosure of which Rhinelander rejected. *See* Tr. 588-89; Exs. 325, 326, 1594, 1594A. In fact, Bebo did not want to disclose the mechanics of the 997 account to prospective buyers at all. Ex. 326.

The second material issue, the degree to which the Board understood the covenant calculation process at different times, is very simple in some respects. Two particularly salient points bear on this. First, all five former Board members whose testimony is in the record denied understanding prior to March 6, 2012 that employees had been included in the covenant calculations, and the four who testified in person possessed very believable demeanors. Tr. 564-71, 1360-61, 2645-51, 2816-22; Ex. 492A at 130-31, 137-38. Second, there is literally no

[5] Although the entirety of Exhibit 1173 is under seal because it memorializes a confidential agreement to settle the arbitration, the cited letter is not covered by the settlement agreement's confidentiality provision. Ex. 1173 at 527105-06.

evidence – notably, not even testimony from Bebo – that the Board knew prior to March 6, 2012, that: (1) Bebo's selection of employees was unilateral and essentially arbitrary; (2) the number of such employees was determined by backfilling; (3) ALC was not tracking employee stays; or (4) Grant Thornton lacked complete knowledge of the covenant calculation process. *See* Tr. 1964-65, 4092. Even assuming that Bebo told the Board before 2012 that employees were included in the covenant calculations, that fact neither exonerates her nor undermines a finding of scienter.

I do not credit Bebo's testimony that she informed the Board of details of the covenant calculation process, beyond the fact that employees were included in the covenant calculations, prior to March 6, 2012. Bebo testified during the hearing that she first told the entire Board that employees were included in the covenant calculations at the November 3, 2009, Board meeting. Tr. 2023-24, 2039-40. She testified similarly during the investigation, although she was not sure of the date of the Board meeting, and further testified that the next time the Board discussed the issue was in 2012. Tr. 2041-42. She also testified at the hearing that she told the Board at its November 3, 2009, meeting that: (1) Ventas had agreed that non-residents could be included in the covenant calculations if they had a "reason to go" (Tr. 2024); (2) ALC was using people to meet the covenant calculations even if they did not visit Facilities (Tr. 2025); (3) Ventas had agreed that there was no limit on the number of non-residents ALC could include in the covenant calculations (Tr. 2025); (4) ALC was including approximately fifty employees in its covenant calculations at the time (Tr. 2026); and (5) employees that work at Facilities were included in the covenant calculations (Tr. 2030). In light of Bebo's overall lack of credibility, the complete absence of corroboration, the Board members' affirmative disagreement, and her continued lack of candor at the March 6, 2012, CNG committee meeting, I do not credit Bebo's testimony that she made these five representations to the Board at its November 3, 2009, meeting (or at any time prior to March 6, 2012). *See, e.g.*, Tr. 1364-66 (Buntain testified that he did not know at the November 3, 2009, Board meeting that employees were included in the covenant calculations), 1372-73. For the same reasons, I do not credit Bebo's uncorroborated testimony that, "[g]enerally speaking," Buono told the Board at its November 3, 2009, meeting how ALC accounted for non-residents in the covenant calculations, including the mechanics of the 997 account. Tr. 2031, 2066.

In one respect, however, the question of what the Board understood about the covenant calculation process at different times is exceptionally knotty. Specifically, the evidence bearing on whether and when the Board knew that employees were included in the covenant calculations is, simply put, all over the place. The many percipient witnesses who testified on this issue gave strikingly inconsistent testimony. The documents, too, are not entirely consistent. *Compare* Ex. 319 ("You had mention[ed] to the board previously about the way you were meeting the covenants on leases no?") *and* Ex. 1115 ("We make adjustments top side to pay for our employee rooms"), *with, e.g.*, Ex. 327 (email chain involving Bebo, Buono, and Bell discussing reperforming the covenant calculations without including employees). Nonetheless, I have read the entirety of the hearing transcript, reviewed every admitted exhibit, and carefully considered all of the parties' arguments on this issue, and I conclude that the Board as a whole did not know prior to March 6, 2012, that employees were included in the covenant calculation process. To the extent the record contains evidence inconsistent with this finding, such evidence is not credible or is accorded little weight.

It suffices to discuss the evidence most likely to be reliable and most on point, and therefore of the greatest weight: the official Board-related documents. At no time prior to March 6, 2012, do the minutes of ALC's Board meetings, audit committee meetings, or CNG committee meetings explicitly mention anything about including employees in the covenant calculations. For instance, at the February 23, 2009, Board meeting, Bebo reported that "management may seek relief [from] certain of the covenants in connection with a request from the landlord that [ALC] consider the purchase of two unrelated residences," and that the covenants had been met, but the covenants were otherwise not discussed. Ex. 100 at 273-74. At the August 4, 2011, audit committee meeting, Buono twice mentioned that "all covenants under the CaraVita lease with Ventas were met," and the committee addressed the July 21, 2011, letter from the Division of Corporation Finance, but the covenants were otherwise not discussed. Ex. 115 at 101-02, 104; Ex. 295. By contrast, at the April 10, 2012, Board meeting, the "Ventas matter," including ALC's regulatory difficulties at the Facilities, constituted the bulk of the Board's discussion. Ex. 122. Similarly, most of the May 15, 2012, Board meeting was taken up with discussion of the "Ventas Transaction." Ex. 123.

Although both Koeppel and Robinson testified that they discussed ALC's inclusion of employees in covenant calculations at multiple ALC audit committee meetings, Grant Thornton was unable to locate any documentation of such discussions. *Compare* Tr. 3335-37, 3430-31, 3435-36, *with* Tr. 3515-16. The only documentation Grant Thornton could locate was an agenda for a discussion with ALC's audit committee chair in April 2011, referencing simply "Caravita covenants," and a presentation to ALC's audit committee in November 2010, with a line item stating merely "Caravita covenants – Minimum average occupancy." Tr. 3515-16; Ex. 1744; Ex. 1744A at 85904; Ex. 1744B.

But the most probative documents pertaining to the Board's understanding of the covenant calculation process, and of Bebo's desire to keep the Board in the dark about it, are the materials provided to the Board before each meeting. For each Board meeting at issue, the Board materials stated in their first section (a hardcopy of a PowerPoint presentation) that "[a]ll covenants on Cara Vita lease with Ventas passed," or words to that effect, and provided a chart showing the results of the covenant calculations with employees included, but without disclosing that inclusion. *E.g.*, Ex. 77 at 34, 37 (of 84 pdf pages); Ex. 3005 at 43, 44 (of 139 pdf pages); *see* Tr. 575 (describing PowerPoint presentation). No packet of Board materials at any relevant time explicitly stated that ALC had violated the covenants, or would have violated the covenants without including employees in the covenant calculations. *See* Tr. 2035.

To be sure, the Board materials contained data that would have allowed any Board member, had he or she examined such data while "searching for inconsistencies," to conclude that the percentages presented in the PowerPoint presentation might be inaccurate. Tr. 716. But such inconsistencies were buried in the paperwork. For example, for the November 2008 Board meeting, before ALC started violating the covenants, the Board materials included a detailed memorandum on covenant compliance from Buono, but for the February 2009 Board meeting, the first one after ALC started violating the covenants, there was no such detailed memorandum. *Compare* Ex. 76 at 1171-88 (November 2008), *with* Ex. 80 at 1586-610, 1614-17 (February 2009). Thereafter, the Board materials continued to be opaque. The materials distributed prior to the November 2009 Board meeting included a sixty-four page PowerPoint presentation, an

Appendix of approximately sixty pages containing various schedules and supporting documents, including a three page summary of the covenant calculations, and a seventeen page Occupancy Summary that broke down occupancy for the previous six weeks, including occupancy for each Facility. Ex. 81 at 2322, 2351-52, 2407-09; Ex. 2133 at 8-9 (of 18 pdf pages); *see* Tr. 2869 (Rhinelander "believe[d]" he received the Occupancy Summary before at least one Board meeting). Two pages of the PowerPoint presentation and two of the Appendix pages indicated that the covenants had all been met, and in particular that average portfolio occupancy for the trailing twelve months was 82.0%, exactly at the threshold. Ex. 81 at 2352, 2408-09. But one of the Appendix pages indicated that occupancy for "CaraVita" for the previous nine months was 74.2%, well below the trailing twelve month threshold of 82%. Ex. 81 at 2407. Similarly, one page of the PowerPoint presentation contained a bar chart that, with some number crunching, would have shown that for the previous quarter occupancy for seven of the eight Facilities, collectively, was 66.87%. Tr. 714-16; Ex. 81 at 2322. The Occupancy Summary likewise showed that occupancy over the previous six weeks for each Facility ranged from 50% to 71%, with only two Facilities exceeding the quarterly threshold of 65%. Tr. 2869-70; Ex. 2133 at 8-9 (of 18 pdf pages).

Tellingly, these inconsistencies were not presented to the other non-ALC constituencies to which Bebo was accountable – specifically, Grant Thornton, Ventas, and ALC's shareholders. Of these constituencies, the Board was the most likely to overlook any inconsistencies, because the Board was the most likely to trust and support ALC's management. Bebo could have reasonably assumed that the Board would not "search[] for inconsistencies," or, for that matter, even read the entire packet of meeting materials. Tr. 716; *see* Tr. 710 (Bell testifying he "didn't look at that"), Tr. 2596-97. Bebo's argument that the Board materials demonstrated "[d]isclosure of the alleged fraudulent conduct to the [Board]," and that such disclosure weighs against a finding of scienter, is unconvincing. Resp. Br. at 267. Indeed, the obscurity of the Board materials demonstrates exactly the opposite. On balance, the evidence shows that Bebo failed to explicitly "report the defaults to . . . ALC's [Board]," and that she led the Board to falsely believe "that ALC was in compliance with the covenants." OIP at 5. Such conduct strongly supports a finding of scienter.

6. Disclosures to Quarles

Quarles was ALC's outside counsel for securities matters from 2006 to at least 2012. Tr. 2290, 2295-96. Although several Quarles attorneys handled matters for ALC during that time, the only one who testified was Bruce Davidson (Davidson), who coordinated Quarles' corporate finance securities group for many years and retired in 2010. Tr. 2289, 2295-97. According to Davidson, who consulted on ALC's "SEC reporting and compliance" for Quarles after his retirement, Quarles generally reviewed drafts of ALC's Commission filings, and sometimes advised ALC regarding its Forms 8-K. Tr. 2290-91, 2296-98. Davidson became aware of the notices of default Ventas sent ALC in early 2012, shortly after another Quarles attorney learned of them. Tr. 2292-94.

The evidence pertaining to Quarles is generally immaterial. Quarles wrote an April 26, 2012, letter to Bebo stating that she "acted reasonably" in connection with certain aspects of the covenant calculation process. Ex. 1037 at 6624. The letter is insufficiently detailed, and is not

based on a complete understanding of the facts, and so does not constitute a competent "reasonableness opinion." *Id.*; *see* Tr. 608 (Bell characterizing the exhibit as a "note of support"); Resp. Br. at 20 (characterizing the exhibit as a "reasonableness opinion"). It also has no bearing on the truth or falsity of the Compliance Statements or the Belief Statements, and because it was issued after all alleged misconduct ceased, it does not support an advice of counsel defense. *See* Resp. Br. at 181, 205. Quarles' advice regarding disclosures in periodic filings and settlement negotiations with Ventas also post-dated the cessation of all alleged misconduct and are likewise immaterial. *See, e.g.*, Resp. Br. at 205; Resp. Reply Br. at 38-39; Tr. 3460; Ex. 1068A.

However, the evidence pertaining to Quarles is material as to one issue: scienter. Davidson, who had a very credible demeanor, testified that until April 4, 2012, he was not asked for advice on the legality of ALC including employees in the covenant calculations, and was not even aware of the practice. Tr. 2292-95. Davidson learned of the practice on April 4, 2012, when Bebo sent another Quarles attorney an email, to which was attached a memorandum from Bell describing the practice. Tr. 2293; Exs. 333, 334. Bell's memorandum describes no other pertinent details of the covenant calculation process. *See* Ex. 333. Also, Quarles' April 26, 2012, letter, purporting to opine on the reasonableness of the practice, does not recite any pertinent details of the covenant calculations process beyond the inclusion of employees in the covenant calculations and certain specifics of the January 20, 2009, call and the February 4, 2009, email. *See* Ex. 1037.

These facts support a finding of scienter, because Bebo concealed from Quarles the full scope of ALC's covenant calculation process, even as late as April 26, 2012, when Quarles opined on it. Even Bebo testified that she did not disclose anything about the process to Quarles until mid-2011, in connection with the letter to ALC from the Division of Corporation Finance. Tr. 2176-77.

In fact, Bebo's testimony on that point, and her hearing testimony on this subject overall, was incredible. In addition to all the reasons why her testimony was unbelievable generally, the Division's cross-examination of her regarding Quarles was especially powerful. At the hearing, Bebo testified that in mid-2011 she personally told Quarles: (1) that Ventas had agreed that people with a reason to go to Facilities could be included in the covenant calculations; (2) that there was no cap on the number of employees that could be included; (3) the approximate range of the number of employees included in the covenant calculations at that time; and (4) that a person could be listed at more than one property. Tr. 2180-81. She also testified that her discussion with Quarles at that time was intended to "lay[] the groundwork for" a decision on whether ALC's periodic filing disclosures made sense "in light of the employee leasing program." Tr. 2183. This testimony was generally consistent with Bebo's April 10, 2014, investigative testimony. *See* Ex. 501 at 1081-87; Tr. 2178-79.

However, it was strikingly inconsistent with Bebo's earlier investigative testimony. *See* Tr. 2184-89. On October 21, 2013, Bebo testified that until March 2012, when the Board asked her to obtain a reasonableness opinion, Fonstad was the only attorney she spoke to about whether employees could be included in the covenant calculations; she did not invoke attorney-client privilege or otherwise suggest that she could not answer the Division's questions. Ex. 496 at 110-11. Bebo testified similarly on October 22, 2013, and when asked specifically about

Quarles, she stated, "I don't know if [Quarles] knows." Ex. 497 at 303-06, 313-14. In other words, Bebo not only provided a false account at the hearing and during her later investigative testimony, but her story changed during the investigation itself from one false account to another.

7. Bebo's Prior Testimony

Thirty-eight pages of Bebo's post-hearing reply brief comprise an "Appendix" purporting to demonstrate "improper impeachment by the Division that should not be considered in any way to impugn Ms. Bebo's credibility" and "seemingly proper" impeachment where "Ms. Bebo's hearing testimony and other context provides a logical explanation that vitiates any negative inference about her otherwise credible testimony." Resp. Reply Br., Appendix at 1, 27. The Appendix contrasts Bebo's prior testimony, as elicited at the hearing, with other statements found in her prior testimony, and provides the context surrounding her testimony. *Id.* at 1-38. In essence, the Appendix is Bebo's effort to rehabilitate herself in writing rather than in open court.

Some of Bebo's points have merit. Bebo was purportedly impeached three times on the issue of Solari's alleged agreement regarding "persons" having a "reason to go" to Facilities. Tr. 1905-07, 1909-11, 1913-14. The first two instances of impeachment involved use of Bebo's October 21, 2013, investigative testimony. Tr. 1905-07, 1909-11 (citing Ex. 496 at 82-83). In context, it appears that those portions of Bebo's investigative testimony used for impeachment referred only to the first part of her conversation with Solari, and that (according to Bebo) she and Solari later agreed on "people that would have a reason to go." Ex. 496 at 87. Second, Bebo was purportedly impeached regarding her views on the materiality of defaulting on the occupancy covenants. Tr. 2229-31. However, her prior testimony was taken out of context; she did not clearly testify that she considered an occupancy covenant default, as opposed to a regulatory covenant default, to be material. Tr. 2229-31; *see* Ex. 502 at 1267-72. Also, five instances of purported impeachment are explained by the fact that Bebo's memory had been refreshed subsequent to her prior testimony. *See* Tr. 1858-59, 1955-57, 1981-83, 2192-93, 4692-93; Resp. Reply Br., Appendix at 27-33.

I have considered the other instances of impeachment addressed in the Appendix, and do not find them to have been improper or misleading. Accordingly, they do, in fact, "impugn Ms. Bebo's credibility." Resp. Reply Br., Appendix at 1.

B. Immaterial Issues

1. Milbank's Investigation and Report

On May 2, 2012, Grochowski sent a whistleblower letter to ALC's audit committee. Exs. 353, 1132. The next day, the audit committee hired the law firm Milbank, Tweed, Hadley & McCloy LLP (Milbank) to conduct an internal investigation. Tr. 616. Milbank presented its findings to ALC's Board by conference call on September 21, 2012. Tr. 622-23; Exs. 558, 1879. It also presented its preliminary findings informally to Grant Thornton on multiple occasions starting in May 2012, and its formal findings on December 17, 2012, and February 15, 2013. Tr. 3455-56, 3460-61, 3463, 3472-73; Exs. 1873, 1880, 1918, 3455, 3460.

On June 10, 2015, in a telephone conference with the parties and the attorneys representing Milbank and ALC, I ruled that Milbank's notes from its investigation were protected as attorney work product, and reserved ruling on whether in-person testimony by the Milbank investigating attorneys would be permitted. Prehearing Conference Tr. at 91-95 (June 10, 2015). Neither party called the Milbank investigating attorneys as witnesses. Consequently, the only evidence pertaining to the Milbank investigation comes from Board members, Grant Thornton personnel, and the various notes and other documents they created. That is, the evidence pertaining to the Milbank investigation is all hearsay.

Bebo cites to Milbank's report in support of various points. *E.g.*, Resp. Br. at 132, 157-61, 172, 205-06. The Division barely cites to it at all. *E.g.*, Div. Br. at 41, 43. After considering the evidence pertaining to the Milbank investigation in light of the standard for evaluating hearsay, I accord no weight to it. *See Joseph Abbondante*, 58 S.E.C. 1082, 1101 & n.50 (2006), *pet. denied*, 209 Fed. App'x 6 (2d Cir. 2006). On the one hand, the statements by the persons Milbank interviewed were often consistent with those persons' in-hearing testimony and corroborated by other evidence, and the statements by the Milbank attorneys themselves were generally consistent as between the Board and Grant Thornton. Exs. 558, 1873. Bebo was a notable exception; she told Milbank that she did not tell Solari that employees would be used for purposes of covenant compliance. Ex. 558 at 6 (of 11 pdf pages). Also, the Milbank investigating attorneys were unavailable to testify because doing so would disclose attorney work product.

On the other hand, the probative value of the Milbank evidence is generally low. The investigation commenced literally days before the cessation of all alleged violations in this proceeding, and its factual findings were based only on ALC documents and interviews of sixteen ALC personnel, with no evidence directly from Grant Thornton or Ventas, except for an unenlightening conversation with Solari. Ex. 558 at 1, 5 (of 11 pdf pages); Ex. 1873 at 594162-63. Its reliability is at best doubtful; Milbank "was not able to conclude that [ALC] was not in compliance with the lease," but did conclude, contrary to even the evidence it had gathered, that it could not disprove "the assertion that some persons at Ventas approved the leasing arrangement." Ex. 558 at 10 (of 11 pdf pages); Ex. 1873 at 594164. Milbank's "self-refuting" conclusions suggest that it was predisposed toward finding no impropriety by its client; that is, Milbank was apparently biased. Tr. 667. The statements by Milbank to Grant Thornton and the Board were oral and unsworn; it is not clear whether the statements by the various ALC interviewees to Milbank were oral and unsworn, but there is no reason to think they were not; and the statements by the interviewees were at least double hearsay. Ex. 558; Ex. 1873. On balance, the evidence pertaining to Milbank's investigation is entitled to no weight, and the points Bebo makes in connection with it are accordingly immaterial. *E.g.*, Resp. Reply Br. at 12-14.

2. Spoliation

Bebo devotes eight pages of her opening post-hearing brief to the issue of spoliation of handwritten notes she took between 2008 and 2012. Resp. Br. at 255-62. However, Bebo concedes that the Division was not responsible for any spoliation. *Id.* at 255. Consequently, no adverse inference or other sanction against the Division is permissible. *See Bracey v. Grondin*,

712 F.3d 1012, 1018-19 (7th Cir. 2013) (sanction for spoliation requires proof of bad faith destruction of evidence by adverse party).

This issue is therefore immaterial and none of the disputes related to it need to be resolved. Bebo nonetheless argues that the issue supports her claim that these proceedings denied her due process, because she could not "explore the party responsible for spoliation." Resp. Br. at 255. This argument is unpersuasive, for four reasons. First, the Commission's Rules of Practice provide for both documentary and testimonial subpoenas, which would have been sufficient to obtain the evidence Bebo sought, if it existed. *See* 17 C.F.R. § 201.232 (Rule regarding subpoenas). Although the Rules of Practice do not provide for depositions, Bebo does not explain how the lack of depositions in any way hampered her. Resp. Br. at 255. Second, at Bebo's request I issued two subpoenas seeking such evidence, to ALC and to Milbank, and the response from ALC included the production of a substantial number of binders and notepads, about which Bebo testified at length. Tr. 3929-54. Third, Bebo already sought the allegedly spoliated documents in other litigation, apparently without success, and there is no reason to think that the result would be different now. Tr. 3276, 3863, 4262. Fourth, Bebo fails to explain how the results of her "explor[ation]" of any spoliation would be relevant to this proceeding. Resp. Br. at 255. Bebo's suggestion that proof of spoliation by a Division witness could have a bearing on that witness' credibility is purely speculative. *Id.*

3. Expert Evidence

Bebo offered the opinions of three experts, David B. H. Martin (Martin), John Durso (Durso), and David C. Smith, Ph.D (Smith). Exs. 2185-87. Smith's opinion pertains to materiality and is addressed *infra*.

Martin provided two opinions. First, he opined that "ALC could reasonably have concluded" that its Lease with Ventas "was not a 'material definitive agreement' or 'material contract' under the disclosure rules of the SEC applicable to ALC and, accordingly, would not have been required to be disclosed or filed" in a periodic filing. Ex. 2187 at 2-3 (of 46 pdf pages). He formed his opinion based on application of various Commission regulations and rules to assumed facts. *Id.* at 3-9 (of 46 pdf pages). Second, he opined that ALC could reasonably have concluded that it was not omitting material information in its disclosures regarding compliance with the financial covenants. *Id.* at 9 (of 46 pdf pages). He formed his opinion based on application of *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), to assumed facts. *Id.* at 9-14 (of 46 pdf pages). Martin's opinions are legal conclusions on dispositive matters and are entitled to no weight. *See Good Shepherd Manor Found. v. City of Momence*, 323 F.3d 557, 564 (7th Cir. 2003).

Durso provided three opinions. First, he opined that ALC's Lease with Ventas was long, complicated, internally inconsistent, and contained ambiguities. Ex. 2185 at 11-12 (of 25 pdf pages). He formed his opinion based on reading the Lease. *Id.* Second, he opined that ALC complied with the Lease's financial covenants. *Id.* at 13-16 (of 25 pdf pages). He formed this opinion by reading the Lease in light of assumed facts. *Id.* Third, he opined that the ultimate purchase price for the Facilities, which resulted from settlement of the lawsuit filed by Ventas against ALC in April 2012, was within industry standards, that the actual purchase price was a

more appropriate valuation of the Facilities than their appraised value, and that the purchase was "advantageous for ALC from a cash flow perspective." *Id.* at 16-17 (of 25 pdf pages); Tr. 3148-49, 3159.

Although I have credited Durso's opinion that the Lease was complicated by industry standards, his first opinion is otherwise merely his interpretation of the Lease, and is entitled to no weight. *See Delta Mining Corp. v. Big Rivers Elec. Corp.*, 18 F.3d 1398, 1402 (7th Cir. 1994). His second opinion is a legal conclusion on a dispositive matter and is entitled to no weight. *See Good Shepherd*, 323 F.3d at 564. His third opinion appears to have been formed based principally on evidence and calculations not disclosed in his expert report. *See* Tr. 3150-54 ("Cap rates are not listed in my report."). Although his qualifications as a health care attorney are impressive, he has insufficient expertise in real estate appraisals to render an opinion on the subject. Tr. 3163, 3167-72, 3176; Ex. 2185 at 1-7. It is beside the point that ALC's purchase of the Facilities improved its cash flow, because ALC's cash flow would presumably have been even greater had it settled Ventas' lawsuit on better terms. That fact is in any event readily ascertainable from the record, and expert evidence on the subject is therefore superfluous. *E.g.*, Tr. 4607-08; Ex. 1108A at 113067. Accordingly, Durso's third opinion has been given no weight. *See Lewis v. CITGO Petroleum Corp.*, 561 F.3d 698, 705 (7th Cir. 2009) ("[f]or a witness to be considered an 'expert,' [Fed. R. Evid. 702] requires that person to be qualified as such"); *Minasian v. Standard Chartered Bank, PLC*, 109 F.3d 1212, 1216 (7th Cir. 1997) ("an expert's report that does nothing to substantiate [the] opinion is worthless").

4. The Division's Prehearing Brief and Allegedly Exculpatory Evidence

Nineteen pages of Bebo's post-hearing brief discuss alleged falsehoods contained in, and exculpatory evidence omitted from, the OIP and the Division's prehearing brief. *See* Resp. Br. at 8-26. As discussed throughout this Initial Decision, the Division has proven most but not all allegations of the OIP, and much of the evidence Bebo characterizes as exculpatory is not. Otherwise, the content of the Division's prehearing brief has no evidentiary value, the Division is not required to cite exculpatory evidence in its prehearing brief, and the Commission is not required to present exculpatory allegations in the OIP. Bebo's discussion of these issues is therefore immaterial.

IV. CONCLUSIONS OF LAW

A. Antifraud Provisions

Exchange Act Section 10(b) and Rule 10b-5 (collectively, Section 10(b)) make it unlawful for any person in connection with the purchase or sale of any security to (a) employ any device, scheme, or artifice to defraud; (b) make material misstatements or omissions; or (c) engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. Scienter is required to establish violations of Section 10(b). *Aaron v. SEC*, 446 U.S. 680, 695 (1980). Causing liability requires proof that: (1) ALC committed a primary violation; (2) Bebo was a cause of that violation; and (3) Bebo knew or should have known that her act would contribute to ALC's

violation. *See Robert M. Fuller*, Exchange Act Release No. 48406, 2003 WL 22016309, at *4 (Aug. 25, 2003). I find that Bebo violated Section 10(b).

The Division argues that Bebo violated Section 10(b) by making material misstatements and orchestrating a fraudulent scheme. Div. Br. at 47-51. According to the Division, Bebo signed and/or certified ALC's periodic reports, which contained misstatements regarding ALC's compliance with the Ventas covenants. *Id.* at 47. The Division also contends that Bebo violated Section 10(b) because ALC's periodic reports "omitted the critical fact that the sole basis for ALC's so-called compliance with the covenants was its improper inclusion of large numbers of employees and other non-residents." *Id.* But that "critical fact" was superfluous, because the other facts contained in the periodic reports were not misleading – they were flatly untrue. That is, any failure to disclose the inclusion of employees in the covenant calculations was not "necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. § 240.10b-5(b). Thus, the omission of descriptions of the covenant calculation process from ALC's periodic reports is not an independent basis for finding material misstatements under Section 10(b). As for scheme liability, the Division maintains that Bebo executed a fraudulent scheme by including employees in the covenant calculations and concealing key aspects of the covenant calculation process from Ventas and ALC's Board, attorneys, and auditors. Div. Br. at 50-51.

1. Misrepresentations

Section 10(b) makes it unlawful for any person in connection with the purchase or sale of securities to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 17 C.F.R. § 240.10b-5(b); *see* 15 U.S.C. § 78j(b); *SEC v. Jakubowski*, 150 F.3d 675, 678 (7th Cir. 1998). Among other requirements, Section 10(b) generally prohibits an issuer from making public statements that are materially false or that fail to include material facts necessary to make the statements made, in light of the circumstances under which they are made, not misleading. *See* 17 C.F.R. § 240.10b-5(b).

In order for primary liability under Rule 10b-5(b) to attach, the alleged violator must be the "maker" of the misleading statements. *See SEC v. Wolfson*, 539 F.3d 1249, 1257 (10th Cir. 2008). The "maker" of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011). ALC is thus a "maker" as "the entity with ultimate authority over the statement[s]." *Id.* Bebo is also a "maker" because as CEO, she signed ALC's annual reports and quarterly and annual certifications that attested to their accuracy.

The following statements are at issue:

- ALC's statements that it was "in compliance" with "certain operating and occupancy covenants in the CaraVita operating lease" included in nine Forms 10-Q and three Forms 10-K for 2009, 2010, and 2011 (the Compliance Statements). Ex. 2 at 30; Ex. 3 at 38;

Ex. 4 at 42; Ex. 5 at 45; Ex. 6 at 34; Ex. 7 at 36; Ex. 8 at 38; Ex. 9 at 45; Ex. 10 at 32; Ex. 11 at 36; Ex. 12 at 36; Ex. 13 at 43.

- ALC's statements in its Forms 10-Q for the second and third quarters of 2011 and Form 10-K for 2011: "Based upon current and reasonably foreseeable events and conditions, ALC does not believe that there is a reasonably likely degree of risk of breach of the CaraVita covenants" (the Belief Statements). Ex. 11 at 36; Ex. 12 at 37; Ex. 13 at 43.

The Division argues that these statements were false and misleading because actual occupancy and coverage ratios at the Facilities were far below the covenant thresholds. Div. Br. at 47. Bebo argues that these statements were statements of opinion and were objectively reasonable. Resp. Br. at 177-83.

The Supreme Court's recent decision in *Omnicare, Inc. v. Laborers' District Council Construction Industry Pension Fund*, 135 S. Ct. 1318 (2015), sets out the differences between statements of fact and statements of opinion and the circumstances under which statements of opinion can be considered untrue statements of fact. Although *Omnicare* resulted from a claim involving Securities Act of 1933 (Securities Act) Section 11, *Omnicare*'s analysis applies to Section 10(b) because of the similarity in language between the two statutes. Securities Act Section 11 states, "[i]n case any part of the registration statement, when such part became effective, contained an *untrue statement of a material fact or omitted to state a material fact*." 15 U.S.C. § 77k(a) (emphasis added). Exchange Act Rule 10b-5 states, "[i]t shall be unlawful for any person . . . [t]o make any *untrue statement of a material fact or to omit to state a material fact*." 17 C.F.R. § 240.10b-5 (emphasis added).

Citing to *Omnicare*, Bebo argues that the Compliance Statements are statements of opinion because they were uncertain and subjective; Bebo contends that an opinion does not need to be preceded by words like "I believe" or "I think." Resp. Br. at 179-80. Bebo further argues that the Compliance Statements are an assertion of legal compliance, which "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." *Id.* at 180. The Division cites to several cases where courts have held that an issuer's false statements that it is in compliance with contractual covenants violate Section 10(b), including a class action securities fraud case filed against Bebo and ALC arising from these same set of facts. Div. Br. at 48. In the cited order, which resolved a motion to dismiss, the court determined that the plaintiff pled facts sufficient to establish that ALC's statements that it was in compliance with all of its leases, including the Lease with Ventas, were fraudulent when made. *Pension Trust Fund for Operating Eng'rs v. ALC*, No. 12-CV-884-JPS, 2013 U.S. Dist. LEXIS 87568, at *24-27 (E.D. Wis. June 21, 2013).

The Supreme Court held in *Omnicare* that a statement of opinion does not constitute an "untrue statement of . . . fact" by virtue of turning out to be incorrect. 135 S. Ct. at 1325-27. Instead, an opinion statement only constitutes an "untrue statement of fact" when the speaker does not actually hold that opinion. *Id.* at 1326 (noting that a statement of opinion "explicitly affirms one fact: that the speaker actually holds the stated belief"). Citing to Webster's New International Dictionary, the Court described a fact as "a thing done or existing" or "[a]n actual happening," and an opinion as "a belief[,] a view," or a "sentiment which the mind forms of

persons or things." *Id.* at 1325 (modifications in original). Using the example of a CEO making a statement regarding his company's televisions, the Court illustrated the difference between a statement of fact and a statement of opinion: a factual statement that "[t]he TVs we manufacture have the highest resolution available on the market" can be transformed into a statement of opinion by adding "I believe" or "I think" to the beginning of the statement. *Id.* at 1326. Assuming that the company's televisions did not have the highest resolution available on the market, the first version of the statement would be false while the statement of opinion would be true, as long as the CEO actually held that belief. *Id.*

Under this framework, the Compliance Statements were statements of fact while the Belief Statements were statements of opinion. The Compliance Statements assert unequivocally that ALC was in compliance with the financial covenants, while the Belief Statements assert that "ALC does not believe" that there was a reasonably likely degree of risk of breach of the covenants. *See Omnicare*, 135 S. Ct. at 1325.

a. Compliance Statements

But even reading the Compliance Statements as statements of opinion, they were untrue, and Bebo was aware at the time they were made that they were untrue. The Lease specified five covenant requirements that ALC was required to measure and report to Ventas at quarter end: a coverage ratio of 0.8 for each Facility for the trailing twelve month period; a coverage ratio of 1.0 for the Facilities for the trailing twelve month period; minimum average occupancy for each Facility of 65%; minimum average occupancy for each Facility of 75% for the trailing twelve month period; and minimum average occupancy for all Facilities of 82% for the trailing twelve month period. Ex. 142 at 8726. ALC was only able to remain in compliance with all of these covenants simultaneously by including employees in the calculations.

Barron, the Division's expert, reperformed the covenant calculations to determine whether ALC would have met the covenant requirements without including employees, and found that each covenant would have been violated at least once in each quarter during the 2009 through 2011 period. Winterville, Highland Terrace, Peachtree Estates, and Tara Plantation all violated the 0.8 coverage ratio at least once, with Winterville violating it every quarter of 2009, 2010, and 2011. Ex. 377 at 27. The 1.0 coverage ratio was violated every quarter from the fourth quarter of 2009 to the fourth quarter of 2011. *Id.* The 65% occupancy requirement was violated every quarter of 2009, 2010, and 2011 by at least one Facility, with seven of the eight Facilities violating the requirement at least once during that period. *Id.* at 24-25. The 75% occupancy requirement was violated every quarter of 2009, 2010, and 2011 by at least one Facility, with all Facilities violating the requirement at least once during that period. *Id.* at 25. The 82% occupancy requirement was violated every quarter from the second quarter of 2009 to the fourth quarter of 2011. *Id.*

Failure to satisfy any of the financial covenants constituted a breach of the Ventas Lease. See Ex. 142 at 8726 ("The following financial covenants shall be met through the Term of this Lease."). In fact, failure to meet these financial covenants was deemed a default, with no opportunity to cure. Ex. 142 at 8748. Neither Bebo nor ALC had any "good faith basis to conclude that its practice was in compliance with the Lease." Resp. Br. at 187. Nor were the

Compliance Statements conditioned in any way on Ventas' behavior or on the enforceability of certain terms of the Lease. *See* Resp. Br. at 185-94. The likelihood of Ventas suing for breach of the covenants, or obtaining particular forms of relief, has no bearing on whether the covenants were, in fact, breached. Thus, the Compliance Statements were false, and Bebo knew they were false.

b. Belief Statements

ALC's statements that it did not believe that there was a reasonably likely degree of risk of breach of the covenants were likewise false, because at the time these statements were made, ALC was actually in breach of the covenants, and ALC and Bebo knew it. Bebo agreed that starting with the first quarter of 2009, the accounting staff determined the number of employees needed to meet the covenants, and she generally provided the names of those employees. Tr. 1987-88, 4077. Bebo knew no later than February 2009 that ALC would not meet the financial covenants without either negotiating with Ventas over them, or including employees in the covenant calculations. Tr. 4550-51; *see* Tr. 3970-72, 3983-86; Ex. 2199. Bebo knew that including employees in the covenant calculations was not permitted under the Lease, which is why she concealed the practice from Ventas. *E.g.*, Tr. 1903, 2088-89, 2091-92. Indeed, the whole point of the covenant calculation process ALC employed in 2009, 2010, and 2011 was to sustain the pretense that ALC was meeting the financial covenants, when it actually was not. Even under the principal case Bebo relies on, her conduct was plainly inconsistent with a subjective belief that there was no reasonably likely degree of risk of breach of the covenants. *See Podany v. Robertson Stephens, Inc.*, 318 F. Supp. 2d 146, 154-55 (S.D.N.Y. 2004) ("As with all inquiries into someone's state of mind, plaintiffs must typically rely on circumstantial evidence for the defendants' words and actions."); Resp. Reply Br. at 89-92. Neither ALC nor Bebo could have actually held the opinion expressed in the Belief Statements, and, thus, the Belief Statements were false.

c. Scienter

Bebo's subjective lack of belief is sufficient to establish scienter, at least as to the Belief Statements. *See Podany*, 318 F. Supp. 2d at 154. But Bebo's (and ALC's) scienter is also established by other evidence. *See John P. Flannery*, Securities Act Release No. 9689, 2014 WL 7145625, at *10 & n.24 (Dec. 15, 2014) (scienter means an intent to deceive, manipulate, or defraud, and may be established through "a heightened showing of recklessness"); *Warwick Capital Mgmt., Inc.*, Investment Advisers Act of 1940 Release No. 2694, 2008 WL 149127, at *9 n.33 (Jan. 16, 2008) ("A company's scienter is imputed from that of the individuals controlling it.").

Indeed, the record is replete with evidence of scienter. Bebo provided knowingly false testimony about what was likely the single most important event at issue in this proceeding – the January 20, 2009, call with Solari. Her testimony was strikingly at odds with the other pertinent evidence and inherently unbelievable. Such false testimony supports a finding of scienter. *See Ralph Calabro*, Exchange Act Release No. 75076, 2015 WL 3439152, at *27 (May 29, 2015) ("[I]nconsistent, and ultimately false, testimony on the topic at the hearing is further evidence of [the respondent's] fraudulent intent."). Bebo was impeached a remarkable number of times over

the course of the hearing. In many instances, the impeachment revealed that her account of important facts had changed over time, which suggests that her account was fabricated. *E.g.*, Tr. 1913-14, 1940-41, 1945-47. Bebo actively prevented Ventas from learning how ALC calculated the covenants. Tr. 835-40, 2090-92; Exs. 212, 262. For instance, Bebo told Buono that Ventas could not conduct site visits during meal times, so that it would not discover that occupancy was lower than reported. Tr. 2369. "[A]ttempts to conceal misconduct indicate scienter." *Phillip J. Milligan*, Exchange Act Release No. 61790, 2010 WL 1143088, at *5 (Mar. 26, 2010). That Ventas was a competitor of ALC is irrelevant, because even if Bebo had reason to be "guarded" with Ventas as to other information, she had an obligation to disclose the Facilities' weak performance to it. Resp. Br. at 114-16. Bebo provided Grant Thornton a deceptively incomplete explanation of the covenant calculation process. *E.g.*, Tr. 3366, 3495-96. For example, she never explained the backfilling process. Tr. 3497-98. Bebo repeatedly failed to comply even with her own version of the alleged agreement with Ventas, by identifying persons to be included in the covenant calculations who did not qualify as "persons with a reason to go" to the Facilities. *See* Tr. 2046-47 (Carter Salvani and Dan and Patty Rodwick were relatives of Bucholtz); Ex. 22 at 5 (of 57 pdf pages) (listing Salvani and the Rodwicks as occupants for fourth quarter of 2009); Ex. 25 at 5 (of 51 pdf pages) (same for second quarter of 2010). For three years, and even as late as March 6, 2012, Bebo affirmatively misled the Board about the covenant calculation process and ALC's lack of covenant compliance, and failed to disclose it to Quarles, ALC's securities counsel. *See* Tr. 2294-95; Ex. 100 at 273-74; Ex. 121 at 56239. Bebo deliberately attempted to confuse matters by use of the term "employee leasing" during the investigation and throughout this proceeding. There simply was no employee leasing: no employees executed leases, no effort was made after the fourth quarter of 2008 to tie employee stays to employees included in the covenant calculations, the employees included in the covenant calculations were identified only after the fact, and the imputed revenue from the "leasing" was based entirely on backfilling.

Admittedly, the record does not weigh entirely in favor of a finding of scienter. For example, the lack of any adverse employment action taken against Grochowski after his November 2011 meeting with Bebo and Buono is inconsistent with scienter. But Bebo's arguments on this point are otherwise unpersuasive.

There is no evidence, beyond Bebo's uncorroborated testimony, that she relied on the advice of counsel, or of anyone else. *See* Resp. Br. at 195-96; Resp. Reply Br. at 7-9. Every testifying attorney in a position to provide such advice denied having done so, at least prior to the cessation of the alleged violations. Tr. 1518-21 (Fonstad denied providing such advice); Tr. 2295 (Bruce Davidson, of Quarles, denied providing such advice before April 2012); Tr. 4332, 4356 (Mary Zak-Kowalczyk (Zak-Kowalczyk), ALC's vice president of the legal department after Fonstad's retirement, denied providing such advice); *see also* Tr. 2347, 2380-81. That Grant Thornton never raised any concerns prior to February 2012 is unremarkable, because there is no evidence (again, beyond Bebo's uncorroborated testimony) that it had a complete picture of the covenant calculation process before that time. *See* Resp. Br. at 197, 202-03. That ALC's accounting staff never raised any concerns prior to November 2011 is similarly unremarkable, either because doing so would have potentially jeopardized their employment, or because (like Hokeness) they were not aware of the full scope of Bebo's fraudulent scheme. *See* Resp. Br. at 203-04. That the Board elected, after the fact, not to restate ALC's financial statements for 2012,

or to take action against Buono, has no bearing on Bebo's state of mind. *See* Resp. Br. at 205-06.

Bebo makes much of the fact that ALC's disclosure committee "approved the disclosure" at issue. *See* Resp. Reply Br. at 4-7. This is immaterial, because Bebo signed ALC's periodic reports, and the misrepresentations in them were, necessarily, her own misrepresentations as well. Moreover, there is no evidence (once again, beyond Bebo's uncorroborated testimony) that any member of ALC's disclosure committee, other than possibly Buono, possessed a complete picture of the covenant calculation process, or had any reason to believe that the process had not been approved by Ventas. No ALC disclosure committee meeting minutes prior to March 2012 document discussion of including employees in the covenant calculations. *E.g.*, Exs. 127, 134, 136. That "correspondence" regarding "census" had been discussed does not mean that the nature of the "clarif[ication] as to census" had been discussed; to the contrary, the use of such vague language implies a lack of clarification. *See* Resp. Br. at 119-20 (citing Exs. 125, 126, 1159B). ALC disclosure committee meetings were typically attended by Buono, Hokeness, John Lucey (Lucey), either Fonstad or Zak-Kowalczyk, and other ALC employees who did not testify at the hearing. *E.g.*, Ex. 127 at 45453; Ex. 134 at 45498; Ex. 136 at 45510. Fonstad, Buono, and Zak-Kowalczyk could not recall the committee ever discussing the inclusion of employees in the covenant calculations. Tr. 1619, 2389, 4380-81. Fonstad and Zak-Kowalczyk denied even knowing that employees were included in the covenant calculations prior to March 2012. Tr. 1508, 4339. Hokeness knew that employees were included in the covenant calculations, but had been told (by Buono) that Ventas had agreed to the practice, and did not learn of the backfilling process until April 2012. Tr. 3049, 3088-89, 3121; Ex. 1129. Lucey, too, knew at some unspecified time that employees were included in the covenant calculations, and recalled discussing it during an unspecified disclosure committee meeting. Tr. 3700. But he, too, had been told that there was an agreement with Ventas, and in any event he did not learn the full picture until April 2012 at the earliest. Tr. 3702, 3742.

Bebo's slapdash approach to identifying employees to be included in the covenant calculations, which even Bebo characterizes as "an extremely poor job," also does not undermine her scienter – quite the opposite, in fact. *See* Resp. Br. at 204. ALC's internal accountants, who ultimately reported to Bebo and Buono, were not in a position to question Bebo's selection of employees. Grant Thornton was in a better position to do so and could have done so if it had been more skeptical; in fact, some Grant Thornton audit team members suspected that ALC was not sending the employee lists to Ventas. But Grant Thornton's lack of diligence does not weigh against scienter, in part because Bebo lulled Grant Thornton into not scrutinizing ALC's records more carefully. Bebo's efforts to issue a Form 8-K on May 3, 2012, which would have disclosed the Ventas lawsuit, have no bearing on scienter because the Ventas lawsuit at that time was not based on financial covenant violations. *See* Resp. Br. at 205; Tr. 4482-84.

Bebo argues that she had no financial motive to commit fraud. *See* Resp. Br. at 206-07. But she did have a motive to avoid reputational damage or discipline, because she was an enthusiastic advocate for entering into the Lease. *See* Div. Reply Br. at 32 n.31; Tr. 548, 1354. In short, the record unquestionably demonstrates that Bebo made her misrepresentations with scienter.

d. Materiality

A violation of Exchange Act Section 10(b) and Rule 10b-5 requires a showing of materiality. *Basic*, 485 U.S. at 231-32, 238. "[M]ateriality depends on the significance the reasonable investor would place on the . . . misrepresented information." *Id.* at 240. A statement is material if there is a substantial likelihood that a reasonable investor would consider the statement important in making an investment decision. *Id.* at 231-32. There is no bright-line test of materiality, and it is dependent on the facts and circumstances of each case. *See Matrixx Initiatives v. Siracusano*, 131 S.Ct. 1309, 1318-21 (2011). Staff Accounting Bulletin (SAB) 99 provides guidance regarding materiality determinations in the preparation of financial statements, recognizing both quantitative and qualitative measures to assess materiality. *See* SEC SAB No. 99, 64 Fed. Reg. 45150 (Aug. 19, 1999) (codified at 17 C.F.R. pt. 211). SAB 99 states that the use of a numerical threshold to assess materiality, such as five percent, may be appropriate as a preliminary analysis of materiality. *Id.* at 45151. However, SAB 99 also notes that "exclusive reliance on certain quantitative benchmarks to assess materiality . . . is inappropriate; misstatements are not immaterial simply because they fall beneath a numerical threshold." *Id.* at 45150. Quantitative benchmarks should not be used as a substitute for a full analysis of "all relevant considerations." *Id.* at 45151.

Bebo contends that her misrepresentations were not material as a matter of law. *See* Resp. Br. at 185-94. But the cases Bebo cites are inapposite, because they all involved statements which had been made in good faith, that is, the statements were not material because they were not knowingly or recklessly false or misleading. *See City of Livonia Emps. Ret. Sys. v. The Boeing Co.*, 711 F.3d 754, 759 (7th Cir. 2013) ("[T]he fact that a prediction *may* prove untrue does not justify representing as true a prediction that one knows, to a reasonable certainty, is false." (emphasis in original)); *Kushner v. Beverly Enters., Inc.*, 317 F.3d 820, 831 (8th Cir. 2003) ("[T]he second amended complaint fails to allege with particularity that the defendants knew their statements were untruthful when made."); *Arazie v. Mullane*, 2 F.3d 1456, 1466-67 (7th Cir. 1993) (stating that there was no evidence "which could or should have alerted" accused fraudfeasor of possible legal problem); *In re Bank of Am. AIG Disclosure Sec. Litig.*, 980 F. Supp. 2d 564, 576 (S.D.N.Y. 2013) ("[T]he defendants[] made no incomplete or inaccurate statements."), *aff'd*, 566 Fed. App'x 93 (2d Cir. 2014); *Anderson v. Abbott Labs.*, 140 F. Supp. 2d 894, 906-07 (N.D. Ill. 2001) (accused fraudfeasor had "a good faith dispute as to facts or an alleged legal violation") (citation omitted), *aff'd sub nom. Gallagher v. Abbott Labs.*, 269 F.3d 806 (7th Cir. 2001). Thus, even accepting Bebo's conflation of materiality with scienter and falsity, her misrepresentations were knowingly false, and therefore distinguishable from each of these cases.

The case on which Bebo principally relies, *Zaluski v. United American Healthcare Corp.*, virtually distinguishes itself:

> Further, the statements made in these press releases can be distinguished from those found to be material [in *City of Monroe Emps. Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651 (6th Cir. 2005)]. In *City of Monroe*, once the company chose to speak regarding an objective fact, "it was required to qualify that representation with known information undermining (or seemingly undermining) the claim."

> This objective fact [turned] . . . on a statement that was directly in conflict with data in the company's possession. In *City of Monroe*, the defendants issued a statement that "the objective data clearly reinforces our belief that these are high-quality, safe tires"; the defendants in fact had data that indicated the opposite. In contrast, the complained-of omission in this case is that payments made to [a Tennessee state senator] could have resulted in Tennessee's decision to void the contract or fine the company. There is no evidence that [the defendant] believed either of those actions to be forthcoming.

527 F.3d 564, 575-76 (6th Cir. 2008) (internal citations omitted). Unlike the defendant in *Zaluski*, Bebo made affirmatively and knowingly false statements, rather than omissions about potential consequences. And like the defendants in *City of Monroe*, the Compliance Statements and the Belief Statements were refuted by information in Bebo's possession.

If the materiality of the Compliance Statements and the Belief Statements could be resolved as a matter of law, I would adopt the reasoning of the court that presided over the class actions against Bebo and ALC. *See Pension Trust Fund for Operating Eng'rs v. ALC*, 2013 WL 3154116, at *9 ("[T]he fact of over-reporting [occupancy numbers] alone . . . would establish that ALC breached its Lease with Ventas by providing false representations."); Ex. 364 at 49-54 (summarizing allegations of occupancy covenant violations). But the materiality of the Compliance Statements and the Belief Statements cannot be resolved purely as a matter of law. Instead, all the "relevant considerations" must be considered, and they show that the Compliance Statements and Belief Statements were material.

i. Terms of the Lease Relative to ALC's Operations

On January 7, 2008, ALC filed a Form 8-K, describing the Lease as a "[m]aterial [d]efinitive [a]greement" and attaching a copy of it. Ex. 1 at 2, 4-132 (of 135 pdf pages). In addition to describing the rental payments, the disclosure states the following about the financial covenants:

> The lease contains customary representations and warranties and affirmative and negative covenants, including financial covenants requiring: each community to maintain a coverage ratio of 0.8 to 1.0; the portfolio to maintain a coverage ratio of 1.0 to 1.0; each community to maintain quarterly occupancy of at least 65% and trailing twelve month occupancy of at least 75%; and the portfolio to maintain trailing twelve month occupancy of at least 82%.

Id. at 2. The accompanying press release, attached as an exhibit to the Form 8-K, states that the Facilities "are expected to generate post acquisition annual revenue, adjusted EBITDAR and adjusted EBITDA of $18.0 million, $7.1 million and $2.2 million, respectively" and to "enhance [ALC's] private pay mix, occupancy levels and geographic diversification into highly desirable markets." *Id.* at 133 (of 135 pdf pages).

ALC's categorization of the Lease as material on this basis weighs in favor of materiality. Bebo nonetheless argues that the Lease was not material and ALC was not required to disclose

the Lease as a "material contract" or a "material definitive agreement." Resp. Br. at 162. But Bebo bases her argument on the expert report of Martin, whose opinions carry no weight. *Id.*

Bebo further argues that although ALC "chose to voluntarily disclose and file the Lease as an exhibit," that did not mean that "ALC had arrived at a judgment that the Lease was a material contract requiring disclosure." *Id.* But at the time ALC entered into the Lease, a preliminary analysis would have showed that the Lease was material. ALC's annual revenue as of December 31, 2007, was $225,906,000. Ex. 5 at 21. ALC predicted that the Lease would generate annual revenue of $18 million, which would have resulted in about an eight percent increase in ALC's annual revenues. This is a significant amount, even without consideration of quantitative benchmarks, and a reasonable investor would have considered this information important when evaluating ALC's financial statements.

The potential consequences of a breach of the financial covenants were also material, which likely explains ALC's repeated disclosure of the financial covenants in its periodic filings. Each quarter, ALC highlighted for investors the fact that the Lease contained certain operating and occupancy covenants and warned that the consequences of their breach, including accelerated rent payments and the loss of future revenue and cash flow, "could have a material adverse impact on [its] operations." *See, e.g.*, Ex. 2 at 30. The accelerated rent payments ranged from a high of $26.8 million for the first quarter of 2009 to a low of $16.7 million as of December 31, 2011. *Id.*; Ex. 13 at 43. Had Ventas learned of the covenant breaches during the first quarter of 2009 and taken action to enforce the Lease provisions, not only would ALC have lost the revenue from the Facilities, but the damages would have increased ALC's expenses and decreased its net income.

Barron's opinion explains this point. *See* Ex. 377 at 16-22. Barron opined that "the most relevant quantitative criteria" for determining materiality in this context is generally considered to be the effect on net income, with a range of five to ten percent of net income being the most common threshold. *Id.* at 17. According to Barron's review, Grant Thornton used a threshold of five percent of net income, before taxes and after adding back unusual charges, which was consistent with Barron's experience. *Id.* at 18. Grant Thornton calculated the threshold as $1,153,000 in 2009, $1,195,000 in 2010, and $1,727,000 in 2011. *Id.* Barron opined that the "potential effects of a default" ranged from $35 million in 2009 to $25.6 million in 2011, "which far exceeded Grant Thornton's planning materiality thresholds, indicating the materiality of the potential effects of a default to ALC's financial statements." *Id.* He also opined that the effects of the remedies available to Ventas in the event of default would have been a minimum of sixty-four percent of adjusted net income in all three years. *Id.* at 19. Barron further opined that these effects represented from five to seven percent of stockholder's equity each year, which exceeded the one to two percent of stockholder's equity that is "normally considered to be material to the financial statements." *Id.* at 19-20.

Bebo argues that a default in the Lease does not necessarily mean that the above consequences would ensue. Resp. Br. at 164. For instance, Bebo points to several examples that constituted an event of default under the Lease where Ventas did nothing to assert its remedies. *Id.* at 166. It is impossible to know what course of action Ventas would have taken had it been aware of the financial covenant breaches before 2012, and the above calculations assume worst

case scenarios. It is also possible (but by no means certain) that the accelerated rent provisions of the Lease would have been unenforceable as to some of the Facilities. *See* Resp. Br. at 190-91. But a reasonable investor would have wanted to know whether ALC had breached the financial covenants, because the ultimate risks were so high. Moreover, when Ventas learned that ALC had included employees in the covenant calculations, it quickly moved to amend its pending complaint, which suggests that litigation would likely have resulted had ALC been candid with Ventas. For these reasons, I accord Barron's opinion considerable but not dispositive weight.

ii. Consequences of Default Relative to ALC's Operations

Barron opined that "ALC's settlement of Ventas' lawsuit in 2012 confirms the materiality of a default of the lease covenants." Ex. 377 at 22. Of the $100 million settlement payment by ALC to Ventas, $37.43 million was treated for accounting purposes as a "lease termination and settlement fee," and $8.65 million in leasehold intangible assets was written off. Ex. 2183 at 115, 130 (of 162 pdf pages); Ex. 3369 at 397735. According to ALC's accounting treatment as of July 18, 2012, the Lease termination fee was estimated as $21 million and the "Estimated Damages" were $16 million. Ex. 3369 at 397735. ALC's initial estimate of the market value of the Facilities and other properties purchased pursuant to the settlement was approximately $65 million, and it eventually reported the market value as $62.57 million. Ex. 16 at 6, 10 (of 12 pdf pages); Ex. 2183 at 130 (of 162 pdf pages); Ex. 3369 at 397734-35. Although there are other estimated market values in the record, the only one from a third party appraiser was from CBRE, and it was naturally the most reliable. Tr. 3595-96, 3732-33; *see* Tr. 3166, 3168-69, 3194-95.

According to Barron, these losses reduced net income after taxes by approximately $29.1 million, "representing approximately 111% of ALC's reported net loss of $26.1 million for the year ended December 31, 2012." Ex. 377 at 22. In other words, but for the settlement payment, ALC would have had a modest net profit in 2012 instead of a substantial net loss. Barron also opined that both the purchase price in excess of fair value and the write-off of leasehold intangible assets were independently material to ALC's 2012 financial statements. *Id.*

Barron's opinion on this point, that the materiality of ALC's breach of the Lease is "confirm[ed]" by the terms of the settlement, is very well supported, and I accord it significant weight. Ex. 377 at 22. Bebo's criticisms of this aspect of Barron's opinion are unpersuasive because they are largely based on mischaracterizations. For example, as demonstrated by his numerical analysis, Barron did not opine that "every event of default is necessarily material," nor did he opine that "because ALC disclosed that an event of default could be material, that it automatically is material." Resp. Br. at 165.

Admittedly, the settlement covered both ALC's regulatory breaches and its covenant breaches. *See* Resp. Br. at 164-67. But ALC's contemporaneous description of the lawsuit listed three claims by Ventas – occupancy below covenant requirements, "NOI" below covenant requirements, and pending loss of license, in that order – and noted that Ventas' proposed amended complaint incorporated an expansion of the requested relief to include Lease termination and monetary damages. Ex. 3369 at 397734, 397736. Grant Thornton concurred with ALC's accounting treatment in its audit of ALC's 2012 financial statements, and explicitly

noted that "ALC was essentially paying not only the Lease termination fee, but also for damages as a result of occupancy rates falling significantly below required covenant occupancy rates." *Id.* at 397738. Clearly, both ALC and Grant Thornton believed at the time that the principal settled claim was the one associated with financial covenant breaches; there was, in other words, a substantial causal nexus between ALC financial covenant violations and the (material) financial impact of the settlement.

In contrast, although it is clear that the class action was predicated in part on financial covenant violations, there is no evidence as to how ALC accounted for the $12 million settlement. Ex. 366 at 9. Accordingly, although this amount is relevant in evaluating sanctions, it carries no weight in evaluating materiality.

iii. Smith's Expert Opinion

Smith's expert report and testimony weigh somewhat in favor of a materiality conclusion, despite Smith's overall opinion to the contrary. Smith opined, in summary, that the disclosure of allegations of improper financial covenant calculations was not associated with a statistically significant change in ALC's stock price, and therefore that such disclosure had no impact on ALC's stock price. *See* Ex. 2186 at 3. Smith is a professor at the University of Virginia, has a Ph.D. in finance from Indiana University, and has had a distinguished academic career. *See* Ex. 2186 at Exhibit 1. However, some of his conclusions are not supported by the evidence he cites.

Smith evaluated ALC's stock price response to public disclosures during what he calls the "dispute period" – the period of April 26, 2012, through June 21, 2012. Ex. 2186 at 2. In sum, he found that after accounting for market and industry factors, the disclosures relating to financial covenant calculations were not associated with a statistically significant change in ALC's stock price. *Id.* at 3, 13. Smith noted several significant dates during the dispute period, including the following:

- April 26, 2012: Ventas files lawsuit against ALC, alleging a lease violation due to notices received by ALC from state regulators threatening to revoke operating permits.
- May 3, 2012: ALC announces it would delay its first quarter earnings release and conference call.
- May 4, 2012: ALC discloses the Ventas lawsuit in a Form 8-K. ALC also discloses the internal investigation.
- May 10, 2012: Ventas files motion to amend its complaint.
- May 11, 2012: ALC files a Form 12b-25 (Notification of Late Filing).
- May 14, 2012: ALC files a Form 8-K disclosing the contents of a May 9, 2012, letter from Ventas, which contained a default notice alleging violations of Section 25 of the Lease, Ventas' motion to amend its complaint, and an estimate of the potential exposure and losses from the Ventas lawsuit.

Id. at 7-10.

Smith found that ALC's stock exhibited a statistically significant abnormal decline on May 4, 2012, when the stock price declined by $2.37 or 12.36% to close at $16.80, with an

abnormal return of -11.20%. Ex. 2186 at 15, Ex. 7. Smith attributes this decline in part to the fact that on the previous day ALC's stock price rose 8.31% during the last seven minutes of trading, after ALC announced it would delay its first quarter earnings. *Id.* at 16. According to Smith, the market viewed the delay as positive news, resulting in the gain; the following day, when the news turned out to be negative, the price dropped accordingly. *Id.*

Smith's theory that the May 4, 2012, stock price decline was in part due to the previous day's trading in anticipation of good news is a reasonable one. However, I disagree with Smith's contention that the May 4, 2012, disclosure did not relate to the financial covenant calculations at all. *See* Ex. 2186 at 17. On May 3, 2012, ALC's stock price opened at $17.96 and consistently traded around that level until 3:53 p.m., when ALC announced that it would be delaying its earnings release and conference call. *Id.* at Ex. 8. Over the next seven minutes ALC's stock price briefly dropped before spiking up to $19.17, an increase of $1.21 from its opening price that day. *Id.* It is likely, had ALC not made its delay announcement on May 3, 2012, that its stock would have consistently continued to trade around the $17.96 level. In numerical terms, it stands to reason that $1.21 of the May 4, 2012, decline of $2.37 is attributable to investors' incorrect assumption of positive news, leaving the remaining $1.16 decline attributable to the bad news disclosed in the May 4, 2012, Form 8-K.

That bad news had two components: (1) on April 26, 2012, Ventas instituted a lawsuit alleging that ALC's receipt of notices of intent to revoke permits from state regulators in Georgia and Alabama constituted a violation of the Lease; and (2) "[o]n May 3, 2012, [ALC's] Board of Directors determined to investigate possible irregularities in connection with the [ALC's] lease with Ventas and retained counsel for such purpose." Ex. 2075. Although the Ventas lawsuit was in the public arena for more than one week, according to Smith, "everybody start[ed] talking about the lawsuit" on May 4; prior to then, there was no mention of the lawsuit in analyst reports and Ventas did not disclose it in its Commission filings. Tr. 3649. However, by at least April 17, 2012, analysts were aware of ALC's regulatory issues, including the fact that in February, Georgia state officials moved to revoke the permit of one Facility due to an "imminent and serious threat to the physical and emotional health and safety" of residents. Ex. 575. That is, the regulatory issues that were initially the subject of the Ventas lawsuit were known to the public before May 4, 2012, even if the lawsuit itself was not.

More to the point, the second component of bad news likely contributed to the stock decline on May 4, 2012. First, the reason for the investigation suggested to investors that there were other issues with the Lease in addition to the lawsuit. ALC could have stated that the purpose of the investigation was to investigate Ventas' allegations; it did not. Instead, ALC used the words "possible irregularities" in connection with the Lease, and in a separate paragraph, which suggests problems distinct from those alleged in the lawsuit. Although ALC did not specifically mention the financial covenant allegations, investors could have reasonably assumed that the "irregularities" might end up being substantiated. Second, the decision to hire outside counsel (versus conducting a company-run investigation) signifies to investors that there is an unusual issue or concern warranting additional company expense. In this case, outside counsel was in part necessary due to ALC management's involvement in falsifying the covenant calculations. Although the reasons for hiring outside counsel were not disclosed, investors could

have inferred that the Board did not want ALC management conducting the investigation, which was significant in and of itself.

Smith also found another statistically significant abnormal decline on May 11, 2012, the day after Ventas filed its amended complaint. Ex. 2186 at 18. On that date, ALC's stock price fell $1.31 or 7.40%, resulting in a significant abnormal return of -6.94%. *Id.* at 18-19, Ex. 7. Smith concedes that if Ventas' amended complaint was filed after market close on May 10 then the abnormal returns on May 11, 2012, could have been due to the negative information contained in the amended complaint. *Id.* at 19. However, Smith maintains that the amended complaint "contained no allegations of ALC wrongdoing in relation to the Financial Covenants. In no part of the amended complaint does Ventas mention the Financial Covenants, or make any allegations as to improper calculations of occupancy rates or coverage ratios." Ex. 2186 at 18.

This is true, but does not weigh against a finding of materiality. Ventas first learned of the improperly calculated covenants on April 27, 2012, when ALC proposed a settlement including a release of claims "based upon [ALC] renting rooms on the [Facilities] to certain of its employees and including those employees in certificates and covenant calculations." Tr. 246-49, 613, 2226; Ex. 350 at 151598. On May 4, 2012, seven days later, ALC's Form 8-K disclosed the possibility of irregularities in connection with the Lease. On May 10, 2012, six days thereafter, Ventas moved to amend its complaint to add a claim for violation of Section 25 of the Lease. Ex. 1194 at 1674, 2018-19; Ex. 2076 at 2. Although investors may have known little of the basis for Ventas' motion to amend, it would have taken minimal effort to (correctly) link ALC's May 4 disclosure of "possible irregularities" in connection with the Lease to Ventas' May 10 effort to sue for violation of the Lease. Therefore, the drop in stock price on May 11, 2012, was at least partially attributable to the amended complaint.

Lastly, according to Smith, May 14, 2012, was the first date when the financial covenant calculation allegations were publicly disclosed. Ex. 2186 at 14. ALC's stock price declined $0.37, or 2.26%, which was an abnormal return of -0.40%, but not statistically significant. *Id.* at 14, Ex. 7. Smith concluded that there was no evidence that the information disclosed on this date had an impact on ALC's stock price. *Id.* at 15. Although Smith's conclusion is well supported, it does not imply a lack of materiality. The May 14 disclosure was much more detailed than the May 4 disclosure, but a reasonable investor could have inferred enough information from the May 4 disclosure, combined with Ventas' May 10 motion to amend, that the May 14 disclosure would have added little to the mix. On balance, the May 14 disclosure is best considered as inconclusive evidence.

iv. Bebo's Beliefs and Actions

On balance, Bebo's conduct and testimony supports a finding of materiality. The Division argues that Bebo explicitly agreed that breach of the covenants could be material. Div. Br. at 48-49; Div. Reply at 32. The Division's argument rests on the fact that Bebo signed ALC's Commission filings, which state that breach of the covenants "could have a material adverse impact on [ALC's] operations." Div. Br. at 48-49. But such statements are simply cautionary boilerplate and by themselves shed little light on materiality. Also, the Division's argument that Bebo admitted on May 3, 2012, that ALC was "off side on the covenants and [] we

are facing a material financial impact" is unpersuasive. *See* Div. Reply at 32 (citing Ex. 354 at 513). Bebo wrote this line on May 3, 2012, before she was aware of the whistleblower letter and before ALC had disclosed the Ventas lawsuit. Tr. 2227-29. Bebo credibly testified that she was not referring to the financial covenants, but to the regulatory covenants involved in the initial Ventas complaint. Tr. 2229-30.

On the other hand, Bebo agreed that a potential purchaser of ALC (i.e., a potential investor) would have considered the validity of any agreement with Ventas to include employees in the covenant calculations to be significant. Tr. 2134-36; *see* Div. Br. at 49. Bebo's involvement in the covenant calculation process is also significant. Bebo conducted an elaborate fraudulent scheme to conceal from Ventas that ALC had breached the financial covenants, deceive ALC's auditors about them, and represent to investors that they had been satisfied. Such conduct weighs in favor of materiality because the integrity of management is important to the reasonable investor. *See SEC v. Joseph Schlitz Brewing Co.*, 452 F. Supp. 824, 830 (E.D. Wis. 1978) (integrity of management bears on materiality); 64 Fed. Reg. at 45152 (intent of management may provide significant evidence of materiality). Because Bebo "personally certified the false statements in this case, they can be seen as 'impugn[ing] the integrity of management,' which in itself would be material to investors." *In re Monster Worldwide, Inc. Sec. Litig.*, 251 F.R.D. 132, 139 (S.D.N.Y. 2008) (alteration in original); *see United States v. Hatfield*, 724 F. Supp. 2d 321, 328 (E.D.N.Y. 2010) ("It is well-settled that information impugning management's integrity is material to shareholders."). That is, the mere fact that Bebo acted deceitfully supports a finding of materiality.

v. Investor Testimony

The Division argues that materiality is established by the testimony of actual and potential ALC investors. Div. Br. at 49; Div. Reply at 32. Board members, including Hennigar, who represented ALC's controlling shareholders, repeatedly inquired at Board meetings about ALC's compliance with the financial covenants. Div. Br. at 49. Buntain, another Board member, testified that covenant compliance was important to him as an investor, and was important to Hennigar as well. Tr. 1357-59; *see* Div. Br. at 49; Div. Br. at 32.

This consideration does not weigh in favor of materiality. Bebo correctly points out that, at least in this proceeding, corporate insiders cannot fairly stand as proxies for hypothetical reasonable investors. Resp. Reply Br. at 80 & n.25. Hennigar and Buntain had access to much more information than the average outside investor, and as Board members, they had a fiduciary duty to ALC. Also, several Board members had misgivings about the financial covenants from the start, and two members, including Buntain, abstained from voting to approve the Lease. Thus, Buntain's testimony that covenant compliance was important to him as an investor may reflect the concerns of a fiduciary, rather than the concerns of a hypothetical reasonable investor.

vi. Summary

On balance, a reasonable investor would have considered the falsity of the Compliance Statements and the Belief Statements to be important. It is irrelevant that the settlement produced a long-term cost savings to ALC, because ALC's cost savings would presumably have

been even greater had it settled on terms that incorporated only damages for regulatory breaches. *See* Resp. Br. at 156. Also, that the Lease lacked a definition of "occupancy" and created "flexibility" in calculating the coverage ratio changes nothing. *See* Resp. Br. at 50-57, 66, 181, 190. First, ALC deviated from its normal occupancy determination methodology to perform the Ventas covenant calculations. A reasonable investor would have wanted to know such a fact, and would have otherwise been entitled to assume that ALC used TIPS, as it did for its other occupancy calculations. *See* Ex. 5 at 26-27 (ALC Form 10-K defining "census" and "occupancy"). Second, whatever flexibility existed in the coverage ratio calculations, they still had to comply with GAAP. Ex. 142 at 8766. There is no evidence, beyond Bebo's uncorroborated testimony, that ALC could have legitimately satisfied the coverage ratios by, as Bebo hypothesized, shifting "labor expenses to regional or divisional" books. Tr. 3983-85, 4579-80. Buono, in fact, testified that he "would not allow that" because it would have been inconsistent with GAAP. Tr. 4685-86. And even Bebo admitted that the possibility of increasing occupancy percentages by taking Facility beds out of service would not have increased coverage ratios and would not have fully satisfied the occupancy covenants. *See* Tr. 4562; Ex. 142 at 8722, 8797 (permitting ALC to take up to ten percent of beds out of service); *see also* Exs. 583A, 2199 (analyzing occupancy if ten percent of beds were removed from service); Tr. 4545. Accordingly, the evidence shows that the Compliance Statements and the Belief Statements were material.

e. Other Elements

The misrepresentations at issue appeared in ALC's quarterly and annual reports. Where fraud involves the dissemination of information in public Commission filings, the "in connection with" and jurisdictional elements are generally met by proof of the means of dissemination and the materiality of the misrepresentations. *See Wolfson*, 539 F.3d at 1262; *Semerenko v. Cendant Corp.*, 223 F.3d 165, 176 (3d Cir. 2000); *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1362 (9th Cir. 1993); *SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1171 (D.C. Cir. 1978); *SEC v. Tex. Gulf Sulphur Co.*, 401 F.2d 833, 860-62 (2d Cir. 1968) (en banc). Thus, ALC's and Bebo's misrepresentations meet all the elements of Section 10(b). Moreover, Bebo's participation was essential to ALC's Section 10(b) violations, and she acted with scienter; accordingly, she caused ALC's Section 10(b) violations.

2. Fraudulent Scheme

Generally, Exchange Act Section 10(b) and Rule 10b-5(a) and (c) prohibit schemes to defraud. Rule 10b-5(a) and (c) make it unlawful for any person in connection with the purchase or sale of securities to "employ any device, scheme, or artifice to defraud" or to "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. § 240.10b-5(a) and (c); *see* 15 U.S.C. § 78j(b). "Conduct itself can be deceptive," and there is no requirement that "there must be a specific oral or written statement before there could be liability under § 10(b) or Rule 10b-5." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 158 (2008).

Primary liability under Rule 10b-5(a) and (c) extends to one who employs any materially manipulative or deceptive device or engages in any materially manipulative or deceptive act,

with scienter, in connection with the purchase or sale of securities, and by jurisdictional means. *See John P. Flannery*, 2014 WL 7145625, at *12. This prohibition is broad and "provide[s] a broad linguistic frame within which a large number of practices may fit." *Id.* (citation omitted). It encompasses "the orchestration of sham transactions designed to give the false appearance of business operations," the making of a fraudulent misstatement to investors and the drafting or devising of such a misstatement, and the "falsification of financial records to misstate a company's performance." *Id.*

That is, "scheme liability does not preclude, outright, claims based upon a scheme to misrepresent or omit material facts." *SEC v. Goldstone*, 952 F. Supp. 2d 1060, 1206 (D.N.M. 2013); *see generally John P. Flannery*, 2014 WL 7145625, at *12-*13, *24-*25, *35. Deceptive conduct "irreducibly entails some act that gives . . . a false impression." *United States v. Finnerty*, 533 F.3d 143, 148 (2d Cir. 2008); *see Burnett v. Rowzee*, 561 F. Supp. 2d 1120, 1125 (C.D. Cal. 2008) (stating that a deceptive act is one that has "the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme" (internal quotations and citations omitted)).

The Division correctly contends that in addition to her misstatements, Bebo violated Section 10(b) "by orchestrating the scheme to hide ALC's breach of the covenants from Ventas and investors by using employees and other non-residents in the covenant calculations." Div. Br. at 50. Including employees in the covenant calculations was a sham designed only to achieve the semblance of covenant compliance. Employees included in the calculations did not travel to the Facilities, employees were double-booked (some even designated for three or more Facilities at the same time) for months on end, employee designations were often determined after quarter end, the number of employees was based on backfilling, and some of the individuals included in the calculations were not even ALC employees. At the head of this scheme was Bebo. She came up with the idea, typically determined the employees, and directed that the process be concealed from Ventas.

Bebo argues that the Division's alleged scheme is unrelated to the purchase or sale of securities and "focuses almost exclusively on alleged (but untrue) deceptive behavior toward Ventas." Resp. Reply Br. at 87-89. Not so. A crucial part of the scheme involved adjusting ALC's books so that the fake employee revenue would not artificially inflate ALC's revenues in Commission filings. As part of this process, the fake employee revenue amounts were forwarded to ALC accounting staff to be recorded as revenues through journal entries, with credits to each Facility and debits to an ALC-wide account. Tr. 808-09; Exs. 378, 550. The process allowed ALC to falsely report to investors ALC's compliance with the Ventas Lease. It is irrelevant for purposes of scheme liability that it also had other intended effects, such as deceiving Ventas and reporting numerically accurate cash flows to investors.

Another part of the scheme involved concealing the full extent of the covenant calculation process from ALC's auditors. While Grant Thornton was aware of some aspects of the covenant calculation process, it was under the impression that (1) only employees, contractors, and ALC representatives who actually stayed at Facilities for a business purpose were included in the calculations, (2) ALC was tracking employee stays, (3) Ventas had agreed to the practice, and (4) Ventas was receiving the calculations with the employee information

included. Concealing the full scope of the process from Grant Thornton, while selectively disclosing information it requested, permitted Grant Thornton to issue unqualified audit opinions. The unqualified audit opinions were then incorporated into ALC's periodic filings. This is sufficient, for purposes of scheme liability, to demonstrate a connection to the purchase or sale of securities. *See Rita J. McConville*, 58 S.E.C. 596, 618-19 (2005) ("The filing of false or misleading Forms 10-K with the Commission satisfies the requirement that misstatements or omissions be made 'in connection with' the purchase or sale of a security."), *pet. denied*, 465 F.3d 780 (7th Cir. 2006).

To be sure, the quarterly Facility financial statements forwarded to Ventas as required by the Lease were incorrect and not in compliance with GAAP. But deceiving Ventas was not the only objective of Bebo's scheme. Another objective was the lulling of ALC's investors and auditors into believing that all was well under the Ventas Lease, a result that Bebo achieved and that continued for three years. 17 C.F.R. § 240.10b-5(a). Her scheme clearly satisfied the "in connection with" element of Rule 10b-5(a) and (c). And for the same reasons discussed *supra* in relation to her misrepresentations, her scheme was material, was executed with scienter, and used jurisdictional means.

B. Other Violations

1. Reporting Provisions

Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder require issuers with securities registered under Exchange Act Section 12 to file annual and quarterly reports with the Commission. 15 U.S.C. § 78m(a); 17 C.F.R. §§ 240.13a-1, .13a-13. More specifically, Rule 13a-1 requires issuers to file annual reports and Rule 13a-13 requires domestic issuers to file quarterly reports. *See* 17 C.F.R. §§ 240.13a-1, .13a-13. An issuer violates these provisions if it files reports with the Commission that contain materially false or misleading information. *SEC v. Kalvex, Inc.*, 425 F. Supp. 310, 316 (S.D.N.Y. 1975); *Russell Ponce*, 54 S.E.C. 804, 812 n.23 (2000), *pet. denied*, 345 F.3d 722 (9th Cir. 2003). Exchange Act Rule 12b-20 requires, "[i]n addition to the information expressly required to be included in a statement or report," that any additional material information be added "as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading." 17 C.F.R. § 240.12b-20; *SEC v. Falstaff Brewing Corp.*, 629 F.2d 62, 72 (D.C. Cir. 1980); *Russell Ponce*, 54 S.E.C. at 812 & n.24. Scienter is not required to establish violations of these provisions. *See SEC v. McNulty*, 137 F.3d 732, 740-41 (2d Cir. 1998); *SEC v. Wills*, 472 F. Supp. 1250, 1268 (D.D.C. 1978); *Gregory M. Dearlove, CPA*, Exchange Act Release No. 57244, 2008 SEC LEXIS 223, at *112 (Jan. 31, 2008).

The Division argues that Bebo caused ALC's violations of Exchange Act Section 13(a) and Rules 12b-20, 13a-1, 13a-13 by (1) signing and/or certifying ALC's false and misleading Commission reports and (2) directing the fraudulent scheme. Div. Br. at 51. Bebo argues that there is no basis to conclude that ALC's public filings contained any material misstatements or omissions. Resp. Br. at 214.

ALC violated Section 13(a) and Rules 13a-1 and 13a-13 and Bebo caused those violations. During 2009 through 2011, ALC was a public company that was required to file periodic reports with the Commission. As previously discussed, ALC's quarterly reports for the first three quarters of 2009, 2010, and 2011, and annual reports for 2009, 2010, and 2011 contained material misstatements – namely, that ALC was in compliance with the Ventas covenants and that it did not believe that there existed a reasonably likely degree of risk of breach of the covenants. As CEO, Bebo was ultimately responsible for ALC's periodic reports, certified each report filed during 2009, 2010, and 2011, and signed each annual report for those years. Bebo was aware that these statements were false at the time they were made – that is, she and ALC acted with scienter, even though it need not be proven for these charges – and her actions contributed to the making of the false statements.

ALC did not violate Rule 12b-20. Rule 12b-20 requires the reporting of additional information so that statements made are not misleading. There are no misleading statements at issue for these charges. As previously discussed, both the Compliance Statements and the Belief Statements were flatly false. No additional information could have been provided by ALC to make these statements not misleading without squarely contradicting them. Disclosure that ALC was including employees in the covenant calculations would not have changed the fact that ALC was not permitted to include them in the calculations in the first place. With respect to the Belief Statements, ALC's failure to disclose its covenant calculation process could arguably have violated Rule 12b-20, had ALC subjectively believed that the covenant calculation process was proper. That is not the case here.

2. Books and Records and Internal Controls Provisions

Exchange Act Section 13(b)(2)(A) requires an issuer registered with the Commission pursuant to Exchange Act Section 12 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." 15 U.S.C. § 78m(b)(2)(A). Exchange Act Section 13(b)(2)(B) requires these issuers to "devise and maintain a system of internal accounting controls." 15 U.S.C. § 78m(b)(2)(B). Scienter need not be shown to establish liability under Exchange Act Section 13(b)(2). *Rita J. McConville*, 58 S.E.C. at 622.

Exchange Act Section 13(b)(5) prohibits a person from "knowingly circumvent[ing] or knowingly fail[ing] to implement a system of internal accounting controls or knowingly falsify[ing] any book, record, or account" required to be maintained pursuant to Section 13(b)(2). 15 U.S.C. § 78m(b)(5). Although the case law is mixed, I assume for present purposes that scienter is required to prove a violation of Section 13(b)(5). *See* Div. Br. at 52; Resp. Br. at 213-14; *compare SEC v. Jensen*, Case No. CV 11-5316-R, 2013 U.S. Dist. LEXIS 173532, at *84 (C.D. Cal. Dec. 10, 2013) and *SEC v. Kovzan*, Case No. 11-2017-JWL, 2013 U.S. Dist. LEXIS 147947, at *33 (D. Kan. Oct. 15, 2013), *with SEC v. Lucent Techs., Inc.*, 610 F. Supp. 2d 342, 369 (D. N.J. 2009).

Exchange Act Rule 13b2-1 states that "[n]o person shall[,] directly or indirectly, falsify or cause to be falsified, any book, record or account" subject to Exchange Act Section 13(b)(2)(A). 17 C.F.R. § 240.13b2-1. Scienter is not required for finding a violation of Rule

13b2-1. *Rita J. McConville*, 58 S.E.C. at 620. Bebo argues that the Division must prove that Bebo acted unreasonably. Resp. Br. at 214.

The Division argues that Bebo violated Exchange Act Section 13(b)(5) and Rule 13b2-1, and caused ALC's violations of Exchange Act Sections 13(b)(2)(A) and 13(b)(2)(B). OIP at 11; Div. Br. at 51-53. Specifically, the Division argues that Bebo signed intentionally falsified journal entries that improperly recorded revenue associated with the falsified employee stays at the Facilities. Div. Br. at 52. These falsified transactions were then recorded in ALC's general ledger. *Id.* at 53. Bebo argues that ALC's financial statements as reported to the Commission were not false, and that the purpose of Section 13(b)(2) is merely to ensure that financial statements filed with the Commission are accurate. Resp. Br. at 208-09. She further argues that ALC's use of the 997 account was a key internal control that prevented ALC's public reporting from being incorrect. *Id.* at 211-13. Finally, Bebo argues that Grant Thornton's 2012 year-end opinion supports the sufficiency of ALC's internal accounting controls. *Id.* at 213.

ALC violated Exchange Act Sections 13(b)(2)(A) and 13(b)(2)(B). ALC's books and records were inaccurate with respect to recording employee stays, allocating the imputed revenue to each Facility, and deducting negative revenue from the 997 account. *See* Ex. 377 at 5. Employee stays at the Facilities were not tracked and employees were arbitrarily designated depending on how many employees were needed to achieve covenant compliance. As a result of these fictitious stays, fictitious revenue amounts were booked to each Facility. In order to avoid an overstatement of ALC's overall revenues due to the additional employee-imputed income, a corresponding amount was deducted from the ALC-wide 997 account. These transactions were not compliant with GAAP. ALC accounting personnel involved in this process were uncomfortable with it and believed that it was not in compliance with GAAP. The Division's expert found that the imputed employee revenue failed to meet GAAP requirements for revenue recognition because the imputed employee revenue was neither realized or realizable nor earned. *See* Ex. 377 at 29. This process led to ALC making material misstatements in its Commission filings.

ALC's internal accounting controls were insufficient. Bebo's selection of employees was arbitrary, and the determination of the number of such employees was based on backfilling. ALC's accounting staff generally felt intimidated into participating in a process they viewed as illegitimate. The Division's expert found that ALC's internal controls were insufficient to detect the inclusion and accuracy of employees that should not have been included in the covenant calculations. *See* Ex. 377 at 31-32. Grant Thornton's self-servingly unqualified opinion in March 2012 changes nothing, because even then Grant Thornton did not know all the pertinent facts regarding ALC's covenant calculation process. Nor does the existence of some internal controls, such as the use of the 997 account for ALC's consolidated financial statements, mean that ALC's internal controls were adequate overall. *See* Resp. Br. at 211-13. Conversely, the fact that the numbers reported in ALC's filings were accurate does not mean that ALC had adequate internal controls. *See* Tr. 1756-57. Indeed, a scheme by a company's CEO and CFO to falsify a company's books, for the purpose of covering up the poor performance of several of the company's operating components, would seem to be a paradigmatic example of a lack of internal controls, regardless of the accuracy of the company's financial statements.

As for causing ALC's violations, Bebo played a central role. She was the mastermind behind the entire process of including employees in the covenant calculations. She was the person who determined the employees to be included at each Facility, the length of their imputed stays, and, at least in some instances, the rental rates to be imputed. Bebo was aware that a corporate account consolidated revenues and expenses throughout ALC. Because Ferreri was uncomfortable with the 997 account journal entries, at times Bebo (along with Buono) authorized these entries; there is no evidence she typically did that with other journal entries. Materiality is not an element of proof of a Section 13(b)(2) violation. *See SEC v. World-Wide Coin Invs., Ltd.*, 567 F. Supp. 724, 749-50 (N.D. Ga. 1983); Resp. Br. at 209-10.

More difficult to assess is Bebo's state of mind during this process. The Division argues that Bebo's claimed ignorance of GAAP is no defense, and in any case, she was not ignorant of GAAP or other accounting matters. Div. Br. at 53. The Division cites to Bebo's testimony that she was "familiar with GAAP," that she has "always been comfortable with the financials" of the companies for which she worked, and that she felt competent to testify whether certain alternative methodologies of calculating the coverage ratio would have been consistent with GAAP. *Id.*

The fact that Bebo was not an accountant weighs in her favor. Being a CEO of a public corporation with years of experience dealing with financial statements and at least some familiarity with GAAP does not make Bebo a GAAP expert. Accountants who have been practicing for years can find GAAP complicated. On the other hand, the fact that most of the people involved in the covenant calculation process, including Buono – who frequently complained about keeping the process "real" and said to her that he did not "look good in stripes" – were uncomfortable with the process should have signaled something was amiss to Bebo, even assuming her lack of accounting knowledge. While Bebo was not aware of Herbner's and Schelfout's concerns, she was made aware later on of Grochowski's and Ferreri's, and continued the process anyway. In addition, her scheme was otherwise committed with scienter, as noted *supra*. On balance, I find that Bebo "must have known" that her scheme involved falsification of ALC's books and records and circumvention of its internal controls, such that she acted with a heightened degree of recklessness – that is, with scienter. *See John P. Flannery*, 2014 WL 7145625, at *10 n.24. Thus, Bebo caused ALC's violations of Sections 13(b)(2)(A) and 13(b)(2)(B), and on the same basis Bebo violated Exchange Act Section 13(b)(5) and Rule 13b2-1.

3. Exchange Act Rule 13b2-2

Exchange Act Rule 13b2-2(a) makes it unlawful for a director or officer of an issuer to make or cause to be made a materially false or misleading statement to an accountant or omit or cause to omit any material information necessary to make the statements made not misleading in connection with an audit of financial statements or reports filed with the Commission. 17 C.F.R. § 240.13b2-2(a). The term "officer" includes "president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization." 17 C.F.R. § 240.3b-2.

The Division argues that Bebo made false representations to Grant Thornton when she signed representation letters that falsely stated that ALC "complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of a noncompliance." Div. Br. at 54 (citing Exs. 61-73). The Division also cites the fictitious list of employees and their fictitious length of stays at the Facilities that ALC sent Grant Thornton. *Id.* Bebo disagrees. Resp. Reply Br. at 92-94. Bebo also argues that Rule 13b2-2 requires a showing of scienter, citing *SEC v. Todd*, 642 F.3d 1207, 1220 (9th Cir. 2011), and *SEC v. Espuelas*, 905 F. Supp. 2d 507, 525-26 (S.D.N.Y. 2012).

Bebo violated Rule 13b2-2. She misled Grant Thornton about ALC's covenant calculation process, thus making her representations throughout 2009, 2010, and 2011 that "[ALC] has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance" false. Assuming without deciding that a showing of scienter is required, Bebo acted with scienter because at the time she made her statements to Grant Thornton, Bebo knew that ALC had violated the Ventas covenant calculations.

4. Certification Rule

Exchange Act Rule 13a-14(a) states that Forms 10-K and 10-Q must include specified certifications signed by the issuer's principal executive and principal financial officer. *See* 17 C.F.R. § 240.13a-14(a). One such certification is that the report "does not contain any untrue statement of material fact." 17 C.F.R. § 229.601(b)(31)(i). Rule 13a-14(a) is violated if a required certification contains materially false or misleading information. *See Kalvex*, 425 F. Supp. at 315-16 (finding that Exchange Act Section 13(a) is violated when filed reports are not "true and correct"); *Russell Ponce*, 54 S.E.C. at 812 n.23.

The Division argues that Bebo violated the certification rule because she certified ALC's Forms 10-K and 10-Q when she knew, or was reckless in not knowing, that they contained material misstatements and omissions regarding the Ventas covenants. Div. Br. at 55. Bebo argues that there was no underlying falsity in ALC's Commission filings, and that a violation of Rule 13a-14 does not give rise to an independent cause of action. Resp. Br. at 214-15.

Bebo violated Exchange Act Rule 13a-14(a). Bebo certified nine Forms 10-Q and three Forms 10-K throughout the 2009-2011 period. The certifications that each Form did not contain any untrue statement of material fact were each false. Bebo knew that the Compliance Statements and Belief Statements were false, and she therefore acted with scienter. Also, Rule 13a-14 unquestionably "create[s] liability for individual persons." *SEC v. Goldstone*, No. CIV 12-0257 JB/GBW, 2015 U.S. Dist. LEXIS 116847, at *991 (D. N.M. Aug. 22, 2015); *see Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1061 (9th Cir. 2000) ("[W]hen a corporate officer signs a document on behalf of the corporation, that signature will be rendered meaningless unless the officer believes that the statements in the documents are true."). The case cited by Bebo, *SEC v. Black*, No. 04 C 7377, 2008 U.S. Dist. LEXIS 75812 (N.D. Ill. Sept. 24, 2008), dates from 2008 and decisions since then have held Rule 13a-14 does give rise to an independent cause of action. *See SEC v. Brown*, 878 F. Supp. 2d 109, 118 & n.4 (D.D.C. 2012) (citing cases); *Dian*

Min Ma, Exchange Act Release No. 74887, 2015 WL 2088438 (May 6, 2015) (finality notice imposing sanctions against individual for violating Rule 13a-14).

C. Constitutional Issues

Bebo contends that this entire proceeding is unconstitutional. Resp. Br. at 216-70. One such contention is that this proceeding violates Article II of the Constitution. Resp. Br. at 228-37. This argument is meritless. *Raymond J. Lucia Cos.*, Exchange Act Release No. 75837, 2015 WL 5172953, at *21-23 (Sept. 3, 2015). Nor are her other arguments persuasive.

1. Equal Protection

Bebo argues that she has been denied equal protection because the Commission exercised the authority granted it under Section 929P(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (codified, in pertinent part, at 15 U.S.C. § 78u-2(a)(2)) (Dodd-Frank) to institute the present proceeding, and thereby deny her the right to a jury trial. Resp. Br. at 223-24. She also argues that Dodd-Frank is "facially unconstitutional." Resp. Br. at 221. She cites no authority directly on point. Resp. Br. at 221-24. Instead, she cites two Supreme Court cases addressing state civil commitment laws. *Id.* (citing *Humphrey v. Cady*, 405 U.S. 504 (1972) and *Baxstrom v. Herold*, 383 U.S. 107 (1966)).

Bebo's argument lacks merit. "[L]egislation is presumed to be valid and will be sustained if the classification drawn by the statute is rationally related to a legitimate state interest." *City of Cleburne, Tex. v. Cleburne Living Ctr.*, 473 U.S. 432, 440 (1985). That is, "[e]qual protection does not require that all persons be dealt with identically, but it does require that a distinction made have some relevance to the purpose for which the classification is made." *Baxstrom*, 383 U.S. at 111. Bebo does not clearly identify a "classification" by which she has been treated differently from similarly situated persons, nor does she explicitly assert a "class-of-one" claim. Resp. Br. at 221-24. This alone warrants rejection of her equal protection argument. *See Engquist v. Or. Dep't of Agric.*, 553 U.S. 591, 601 (2008) (equal protection "has typically been concerned with governmental classifications" but also includes claims that the plaintiff "has been irrationally singled out as a so-called 'class of one'").

However, construed broadly, her argument appears to be based on the following classification: "unregulated people accused of securities violations" who are subject to civil penalties in administrative proceedings, as opposed to civil actions. Resp. Br. at 218-19, 224. Dodd-Frank gave the Commission authority to impose civil penalties as a final agency action against any person, if in the public interest and after an administrative proceeding where the respondent has been found to have, in this case, violated the Exchange Act. *Compare* 15 U.S.C. § 78u-2(a)(2) (2010), *with* 15 U.S.C. § 78u-2(a) (2006). Because the Commission also has authority to bring a civil action alleging the same Exchange Act violation, and the court in such a civil action has authority to award civil penalties, Bebo argues that the difference in proceedings is merely a difference in forum. 15 U.S.C. § 78u(d)(3); Resp. Br. at 223-24. The Commission's forum selection authority is therefore unconstitutionally arbitrary, the argument continues, and can result, as in this case, in the denial of a jury trial. Resp. Br. at 223-24.

Accepting for the sake of argument Bebo's framing of the equal protection issue as, in essence, the legality of shopping for the forum "giv[ing] the government its best opportunity to win," there is no unconstitutional infirmity. Resp. Br. at 224. First, Bebo has the burden of proving an equal protection violation when it is premised on the rational basis test. *See Esmail v. Macrane*, 53 F.3d 176, 180 (7th Cir. 1995); *Timbervest, LLC*, Investment Advisers Act of 1940 Release No. 4197, 2015 WL 5472520, at *29 (Sept. 17, 2015). But she cites literally no evidence particular to this proceeding, beyond the mere fact of the proceeding itself, in support of her claim. *See* Resp. Br. at 221-24.

Second, the "Commission's choice to use either [administrative proceedings or civil actions] or both of those means to enforce the securities laws is a matter of broad agency discretion [that] . . . depends on a highly individualized assessment of the facts and circumstances of a given case." *Timbervest,* 2015 WL 5472520, at *29. As the Supreme Court has explained, this is entirely proper:

> There are some forms of state action, however, which by their nature involve discretionary decisionmaking based on a vast array of subjective, individualized assessments. In such cases the rule that people should be "treated alike, under like circumstances and conditions" is not violated when one person is treated differently from others, because treating like individuals differently is an accepted consequence of the discretion granted. In such situations, allowing a challenge based on the arbitrary singling out of a particular person would undermine the very discretion that such state officials are entrusted to exercise.

Engquist, 553 U.S. at 603.

Third, Dodd-Frank's award of forum selection discretion was rationally related to the government's interest in "promot[ing] the financial stability of the United States by improving accountability and transparency in the financial system," by awarding that discretion to the one federal agency with particular expertise in addressing alleged securities law violations. *See Hill v. SEC*, No. 1:15-CV-1801-LMM, 2015 WL 4307088, at *15 (N.D. Ga. June 8, 2015) (quoting Dodd-Frank, Pub. L. No. 111-203, 124 Stat. 1376 (2010)); *see also United States v. Batchelder*, 442 U.S. 114, 125 (1979) ("The prosecutor may be influenced by the penalties available upon conviction, but this fact, standing alone, does not give rise to a violation of the Equal Protection or Due Process Clause."). Thus, *Humphrey* and *Baxstrom*, where state civil commitment laws either failed or were questionable under the rational basis test, are inapposite. *Baxstrom*, 383 U.S. at 111; *see Humphrey*, 405 U.S. at 511. In sum, that Dodd-Frank gave the Commission the authority to follow two different approaches to achieve the same result, even involving "unregulated people accused of securities violations," does not make Dodd-Frank facially unconstitutional or establish an equal protection violation.

2. Due Process

Bebo received a trial before an impartial factfinder lasting four weeks, during which thirty-one witnesses testified and over 1,000 exhibits (most of them Bebo's) were admitted, followed by over 400 pages of post-hearing briefs. She spent multiple days testifying in her own

defense, received a full opportunity to cross-examine the Division's witnesses, and called several witnesses of her own. The process Bebo received in this case was at least equivalent to what she would have received in a district court bench trial, and arguably more. *See In re Nexium (Esomeprazole) Antitrust Litig.*, No. 12-md-02409-WGY, 2015 WL 4720033, at *6 & n.11, *39 (July 30, 2015) (describing how current summary judgment practice has eroded the right to a jury trial in federal civil actions).

Bebo nonetheless argues that Section 929P(a) of Dodd-Frank is also facially unconstitutional because it "[e]ffects a wholesale transfer of Ms. Bebo's constitutional right to a jury trial to the government itself," and penalizes her for possessing or exercising that right. Resp. Br. at 224-27. But Bebo has no such right, because this is an administrative proceeding. *See Atlas Roofing Co. v. OSHRC*, 430 U.S. 442, 455-56 (1977). Bebo nonetheless argues that Dodd-Frank "permits the SEC to file a case in district court and wait to see if the defendant asserts her right to a jury trial," and "then voluntarily dismiss the case and obtain the same remedy administratively." Resp. Br. at 227. Such a scenario seems rather unlikely, and is too speculative to find Dodd-Frank unconstitutional in the absence of evidence that it might ever happen.

Bebo contends that she was not afforded due process for multiple other reasons, as well. *See* Resp. Br. at 263-70. She argues that she was not given adequate time to prepare her defense, that she should have been allowed to treat her own witnesses as adverse, that certain declarations were admitted in lieu of live testimony, and that my evidentiary and subpoena-related rulings were erroneous. Resp. Br. at 238-41, 246-47, 249-51. These points are merely a repeat of arguments she has already made and I have already rejected.

Bebo argues that she lacked access to most witnesses, and had insufficient opportunity to challenge their credibility, "both things she would have had in federal district court," and that the Division improperly "rehearsed" testimony with its own witnesses. Resp. Br. at 242, 245-47. There is no evidence that the Division advised any witness not to talk to Bebo or her counsel, or otherwise improperly hindered her access to witnesses. Bebo was given a reasonable opportunity to question every Division witness about improper coaching, and failed to establish it as to any witness; the examples she cites of such alleged coaching (Buono and Solari) are unpersuasive. As for compulsory access, it is true that Bebo could have deposed at least some of the witnesses against her if this proceeding had been brought in district court – but only if the case against her was a civil action, or a criminal action where the witness's testimony required preservation. *See* Fed. R. Crim. P. 15(a) (governing depositions in criminal cases); Fed. R. Civ. P. 30. Bebo cites no authority supporting the proposition that she has a constitutional right to depose or interview witnesses before the hearing, nor am I aware of any.

Bebo contends that the Division threatened and otherwise improperly influenced witnesses. Resp. Br. at 242-45. But it was perfectly proper to inquire through counsel whether Buono, a putative respondent, would invoke his privilege against self-incrimination, and to suggest cooperation to other witnesses. Exs. 1967, 1970. As noted, the Division's comments to Buono, to the effect that Bebo had "blamed things on [him]," were supported by the record. Tr. 2435. It was also proper for the Division to not fully disclose Bebo's investigative testimony to Buono during the investigation, because doing so might have undermined the investigation's

integrity. *See SEC v. Csapo*, 533 F.2d 7, 9 (D.C. Cir. 1976) (describing the basis of the Commission's "sequestration rule"). That Buntain had a poor memory of his transactions in ALC stock is immaterial, because he otherwise generally had a good memory and demeanor, and the Division's efforts to pin down his securities holdings and transactions were proper. *See* Resp. Br. at 244 n.71.

Bebo argues that she lacked compulsory process for obtaining the testimony of two former Board members, Hennigar and Ng, because they reside outside the United States. Resp. Br. at 247-49, 267-68 & n.74. Now that the record is complete, it is clear that such testimony would likely have been cumulative of the testimony of the four former Board members who testified in person, because all four former Board members were adamant that they did not know all the details of the covenant calculation process. Furthermore, the prior testimony of Hennigar, an excerpt of which I admitted pursuant to Rule of Practice 235, 17 C.F.R. § 201.235, was obtained by Bebo herself in connection with her arbitration, but is plainly inculpatory. *E.g.*, Ex. 492A at 130-31 (Hennigar was not aware that ALC was renting Facility units for employee use); Tr. 4541-42. Had Hennigar testified in the arbitration consistently with Bebo's account of events, I would have entertained a motion by her to admit such testimony, but Bebo instead vigorously opposed the admission of any of Hennigar's prior testimony, even though it would have been admissible even in district court. *E.g.*, Tr. 4540-41; Fed. R. Evid. 804(b)(1). There is thus no reason to think that Bebo's inability to call Hennigar or Ng prejudiced her, or that they were in any sense "key witnesses." Resp. Br. at 247.

Bebo contends that witnesses from Ventas were permitted to testify about matters that Bebo was not permitted to explore through documentary subpoenas. *See* Resp. Br. at 251-53. True, Solari's testimony that he "would never agree" to inclusion of employees in covenant calculations could have been called into question with evidence that he had done so with other counterparties. Tr. 416. But there is no reason to think that such evidence exists. Bebo's counsel questioned Solari about Solari's role as a "liaison" between ALC and Ventas, but did not question him about whether he had been a liaison for other counterparties. Tr. 452. Solari also testified that he had seen Ventas "ma[k]e accomodations to tenants with respect to covenants," but only in return for "value." Tr. 462-63. In fact, under questioning by Bebo's counsel, Solari testified that in connection with the negotiations over the New Mexico properties in early 2009, Solari agreed to a temporary waiver of the Lease's "coverage covenant," but only in return for consideration, including ALC's purchase of a "severely underperforming" Facility, that ALC was not willing to pay. Tr. 454-55; Ex. 3383. Similarly, Doman testified under questioning by Bebo's counsel that Ventas was on "heightened alert about the ALC relationship," but he was not asked if he had ever waived or informally modified covenants with other counterparties. Tr. 346. Most importantly, there is no documentary corroboration for Bebo's testimony that she learned in late 2008 that Old CaraVita included employees residing at Facilities in Old CaraVita's covenant calculations. Tr. 1884-86, 3993-94. Nor is there any evidence, documentary or testimonial, to corroborate Bebo's testimony that Ventas knew Old CaraVita had included employees in its covenant calculations. *See* Tr. 1903-04. Had such evidence ever existed in documentary form, Bebo would have known of it, and could have easily obtained it with a narrowly tailored subpoena.

Bebo argues that she was not allowed to examine witnesses, particularly Buono, using the term "employee leasing." Resp. Br. at 253-54. The origin of the term is obscure. According to Hokeness, Bebo stated in August 2008 that Ventas had permitted Old CaraVita to include employees in covenant calculations. Tr. 3046-47. In May 2012, Grochowski referred to "'leasing' to employee[s]" in his whistleblower letter, but the first documentary use of the term "employee leasing" appears to be in Bell's September 2012 notes of Milbank's investigation findings. Ex. 558 at 4 (of 11 pdf pages); Ex. 1132. That is, it does not appear to have been a term used prior to cessation of the alleged violations.

More to the point, "employee leasing" clearly meant different things to different people at different times, and Bebo's undisciplined use of the term thus confused matters instead of clarifying them. Ventas knew nothing of the term prior to May 2012, which explains why it did not use it in its proposed amended complaint or its May 9, 2012, default notice. Ex. 355 at 154443-44; Ex. 1194 at 1674. Hokeness understood that employees could be included in covenant calculations if they were housed "on site," but did not use the term when he was briefed on the covenant calculation process in February 2009. Tr. 3046-47; Ex. 1129. Grant Thornton initially understood that employees could be included in covenant calculations if they were staying at Facilities. Tr. 3366, 3373. But Grant Thornton did not know of ALC's backfilling, and apparently never used the term until after it was briefed by Milbank. *See* Ex. 1873 at 594164. Herbner, who apparently never used the term in writing, initially understood that employees included in the covenant calculations had actually stayed at Facilities, but later she began backfilling. Tr. 757, 816-17. Schelfout, who also apparently never used the term in writing, continued the backfilling and understood that any employee could be included in the calculations. Tr. 975. Buono distinguished between employee leasing and the inclusion of employees in covenant calculations, testified that his "view" of employee leasing changed over time, and opined that although the Board knew of employee leasing, it did not know of its eventual magnitude. Tr. 2397, 4631-34, 4640, 4648; Ex. 2117. Bebo herself was confused by the term, and her counsel used the term inconsistently. Tr. 1958; *compare* Tr. 2400-01 ("I would like both those concepts included in the term"), *with* Resp. Br. at 3 n.3 (defining employee leasing as only "the practice whereby ALC paid for units . . . for employees with a reason to go to those Facilities," with no explicit reference to covenant calculations). Confusion over the term during the hearing, as well as other examination deficiencies, led me to restrict Bebo's cross-examination of Buono, although I later allowed her to recall him in her own case. Tr. 2404-05, 2744-56; Prehearing Tr. 97-98 (June 10, 2015).

Overall, the term "employee leasing" was so vague as to be objectionable, and I normally sustained the Division's objections to its use. *See generally* Div. Reply at 40-41 & n.35. Bebo, however, typically did not object to its use; for instance, the Division asked numerous questions of Bebo that used the term in a confusing way, without objection. *E.g.*, Tr. 1890-92, 2063-69. I have endeavored to avoid the term entirely in this Initial Decision, and, as noted, Bebo's use of it is evidence of scienter. In any event, being required to ask precise questions, and being barred from asking obfuscating questions, does not violate due process. *See* Fed. R. Evid. 403, Advisory Committee Notes (1972) ("Exclusion for risk of . . . confusion of issues . . . find[s] ample support in the authorities.").

In sum, all of Bebo's due process arguments are meritless.

V. SANCTIONS

The Division requests a cease-and-desist order, disgorgement and prejudgment interest, third-tier civil penalties, and an officer-and-director bar. Div. Br. at 56-59.

A. The Public Interest

When considering whether an administrative sanction serves the public interest, the Commission considers the factors identified in *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981): the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the likelihood that the respondent's occupation will present opportunities for future violations (*Steadman* factors). *See Altman v. SEC*, 666 F.3d 1322, 1329 (D.C. Cir. 2011); *Gary M. Kornman*, Exchange Act Release No. 59403, 2009 SEC LEXIS 367, at *22 (Feb. 13, 2009), *pet. denied*, 592 F.3d 173 (D.C. Cir. 2010). Other factors the Commission has considered include the age of the violation (*Marshall E. Melton*, 56 S.E.C. 695, 698 (2003)), the degree of harm to investors and the marketplace resulting from the violation (*id.*), the extent to which the sanction will have a deterrent effect (*see Schield Mgmt. Co.*, 58 S.E.C. 1197, 1217-18 & n.46 (2006)), whether there is a reasonable likelihood of violations in the future (*KPMG Peat Marwick LLP*, 54 S.E.C. 1135, 1184 (2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002)), and the combination of sanctions against the respondent (*id.* at 1192). *See also WHX Corp. v. SEC*, 362 F.3d 854, 859-61 (D.C. Cir. 2004). The Commission weighs these factors in light of the entire record, and no one factor is dispositive. *KPMG Peat Marwick LLP*, 54 S.E.C. at 1192; *Gary M. Kornman*, 2009 SEC LEXIS 367, at *22.

Bebo committed multiple violations in each of seven consecutive quarters in 2010, 2011, and 2012, as well as five previous quarters, involving multiple distinct violative acts, including false statements in required periodic filings, circumvention of internal controls, falsification of books and records, and false statements to auditors; Bebo's violations were plainly recurrent. She has utterly failed to recognize the wrongfulness of her conduct, and has offered no assurances against future violations, which suggest a likelihood of violations in the future. She continues to have the opportunity to work as an officer or director of a public company; even assuming that she has been "effectively barred from her profession for years," there remains a possibility that she could find comparable employment in the future. Any sanction will have a considerable deterrent effect, and the marketplace, shareholders, and Ventas were clearly harmed. On the other hand, the violations are not especially recent.

But two factors decisively weigh in favor of the heaviest possible sanction: egregiousness and scienter. Bebo's scheme involved the abuse of her position as CEO, the co-option of her fellow ALC employees, and the deception of Ventas, Grant Thornton, and ALC personnel. She corruptly misused her power and authority to betray the trust reposed in her by her subordinates and by ALC's Board, all to avoid the consequences of violating the financial covenants. Her misconduct was a cause of ALC's payment of multi-million dollar settlements, and of a multi-dollar drop in share price on May 4, 2012, ALC's biggest trading day in over a year. *See* Ex. 2186 at Exs. 3, 7-9. Bebo's characterization of her shamelessly egregious

behavior as "a good faith effort to manage a struggling aspect of ALC's business during a recession" is profoundly false. Resp. Br. at 288.

Indeed, knowing falsehood – that is, scienter – was an essential part of her fraudulent scheme. She deceived Ventas, who expected the truth and contracted for it in the Lease. She deceived the Board, who specifically asked for truthful reports on the status of covenant compliance. She deceived Grant Thornton, the whole point of whose work was to ensure truth-telling in ALC's public filings. She started mischaracterizing the January 20, 2009, call with Solari almost immediately after it occurred. She misled Quarles and ALC's Board about her scheme in early 2012, even as the scheme unraveled. During the investigation and her arbitration against ALC, she gave testimony that was often as bewilderingly incredible as her hearing testimony. *E.g.*, Ex. 489 at 279 (Bebo testified in the arbitration that in February 2009 the Board approved inclusion of employees in the covenant calculations); Ex. 496 at 86-87 (Bebo describing the January 20, 2009, call). And over the course of approximately five days on the witness stand during the hearing, she had the breathtaking audacity to tell, under oath, what largely amounted to a fairy tale. The simple truth is that Bebo concocted an elaborate fiction, started telling it over six years ago, and has never stopped.

On balance, the public interest weighs in favor of imposing the greatest possible sanction against her.

B. Cease-and-Desist Order

Exchange Act Section 21C authorizes the Commission to impose cease-and-desist orders for violations of that Act and its regulations. *See* 15 U.S.C. § 78u-3(a). The Commission requires some likelihood of future violation before imposing such an order. *KPMG Peat Marwick LLP*, 54 S.E.C. at 1185. However, "a finding of [a past] violation raises a sufficient risk of future violation," because "evidence showing that a respondent violated the law once probably also shows a risk of repetition that merits our ordering [her] to cease and desist." *Id.*

The relevant factors weigh in favor of a cease-and-desist order, and the incremental prejudice to Bebo arising from a cease-and-desist order, compared to the other sanctions, is minimal. Indeed, she does not vigorously oppose such an order. Resp. Br. at 270. A cease-and-desist order will therefore be imposed.

C. Disgorgement

Disgorgement is authorized in this case by Exchange Act Section 21B(e). *See* 15 U.S.C. § 78u-2(e); OIP at 12. Disgorgement is an equitable remedy that requires a violator to give up wrongfully obtained profits causally related to the proven wrongdoing. *See SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230-32 (D.C. Cir. 1989). The amount of the disgorgement need only be a reasonable approximation of profits causally connected to the violation. *See Laurie Jones Canady*, 54 S.E.C. 65, 84 n.35 (1999) (quoting *SEC v. First Jersey Secs., Inc.*, 101 F.3d 1450, 1475 (2d Cir. 1996)), *pet. denied*, 230 F.3d 362 (D.C. Cir. 2000). Once the Division shows that its disgorgement figure reasonably approximates the amount of unjust enrichment, the burden shifts to Respondent to demonstrate that the Division's disgorgement figure is not a

reasonable approximation. *Guy P. Riordan*, Securities Act Release No. 9085, 2009 WL 4731397, at *20 (Dec. 11, 2009), *pet. denied*, 627 F.3d 1230 (D.C. Cir. 2010). The standard for disgorgement is but-for causation and has nothing to do with the public interest; in essence, disgorgement is always in the public interest. *Jay T. Comeaux*, Securities Act Release No. 9633, 2014 WL 4160054, at *3 & n.18, *5 (Aug. 21, 2014). The combination of sanctions also does not affect disgorgement. *Id.* at *4 n.32.

The Division seeks disgorgement of Bebo's bonuses for 2009, 2010, and 2011, which were $340,185, $374,063, and $399,750, respectively. Div. Br. at 57; Stipulation (Apr. 15, 2015) ¶¶ 13-15. The Division contends that the bonuses were discretionary and that Board members responsible for determining Bebo's salary and bonus testified that they would not have awarded her a discretionary bonus had they known of her misconduct. Div. Br. at 57. I have considered all the cases cited by the Division in support of its position, and I am not persuaded.

Although three former Board members testified that they would not have voted to give Bebo a bonus had they known of her misconduct, this does not mean that the Board as a whole would not have awarded her a bonus. Tr. 653-55, 2659, 2850-51. On the one hand, the five Board members whose testimony is in the record all generally testified consistently with each other, and it is entirely possible that the Board would have voted unanimously to not award a bonus. On the other hand, two Board members, Hennigar and Buntain, were not specifically asked about whether they would have voted for a bonus, and Hennigar was chairman of the Board and effectively ALC's controlling shareholder. *See* Tr. 694-95; *see generally* Tr. 1350-1455; Ex. 492A. The Board was not unanimous when it voted to enter into the Ventas Lease, which at least raises the possibility that it might not have been unanimous had it been asked to vote on a bonus for Bebo. Tr. 552-553. One of the few issues on which the former Board members disagreed was the reason for Bebo's eventual termination, which bolsters the possibility of disagreement on the Board over award of any bonus. Tr. 1390 (Buntain voted to terminate Bebo because she "manipulated the numbers"); Tr. 2563 (Roadman testified that Bebo's handling of the Ventas Lease was not a basis for her termination); Tr. 2849 (Rhinelander testified Bebo was terminated because of "regulatory and care issues"); *see* Ex. 365 at 9, 25 (of 45 pdf pages). Also, any discretionary bonus would presumably have been based on more than simply Bebo's handling of the financial covenants and related matters. *See* Tr. 4167-68 (Bebo's bonus was based on "private occupancy . . . from outside sources").

Indeed, it is not clear that any bonus awarded to Bebo even would have been truly discretionary. *See* Stipulation (Apr. 15, 2015) ¶¶ 13-15 (characterizing the bonuses as "non-equity incentive plan compensation"). The three former Board members who testified about bonuses all characterized them as discretionary. Tr. 653-54, 2659, 2850-51. Nonetheless, the settlement agreement covering the various claims Bebo filed against ALC after her termination includes a letter, dated October 25, 2013, stating that Bebo "earned 100% or more of [her] bonuses, as measured by original or revised targets," which suggests that the Board's discretion was at least somewhat restricted. Ex. 1173 at 527109 (under seal); *see also* Tr. 4506 (under seal) (describing the terms of Bebo's employment contract). On balance, there is insufficient evidence that Bebo's bonuses were causally connected to her misconduct, and no disgorgement will be ordered.

D. Civil Penalties

Under Section 21B(a)(2) of the Exchange Act, the Commission may impose a civil money penalty if a respondent violated or caused the violation of any provision of the Exchange Act or its regulations, and if such penalty is in the public interest. 15 U.S.C. § 78u-2(a)(2). A three-tier system establishes the maximum civil money penalty that may be imposed for each violation found. 15 U.S.C. § 78u-2(b). Where a respondent's misconduct involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, and it directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons, the Commission may impose a "third-tier" penalty of up to $150,000 for each act or omission by an individual for violations occurring, as pertinent here, after March 3, 2009. 15 U.S.C. § 78u-2(b)(3); 17 C.F.R. § 201.1004, Subpt. E, Table 4.

In determining whether a penalty is in the public interest, six factors are considered: (1) whether the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, (2) the resulting harm to other persons, (3) any unjust enrichment and prior restitution, (4) the respondent's prior regulatory record, (5) the need to deter the respondent and other persons, and (6) such other matters as justice may require. 15 U.S.C. §§ 78u-2(c). Within any particular tier, the Commission has discretion to set the amount of the penalty. *See Brendan E. Murray*, Advisers Act Release No. 2809, 2008 SEC LEXIS 2924, at *42 (Nov. 21, 2008); *The Rockies Fund, Inc.*, Exchange Act Release No. 54892, 2006 SEC LEXIS 2846, at *25 (Dec. 7, 2006). "[E]ach case has its own particular facts and circumstances which determine the appropriate penalty to be imposed" within the tier. *SEC v. Murray*, No. OS-CV-4643, 2013 WL 839840, at *3 (E.D.N.Y. Mar. 6, 2013) (internal quotation marks and citations omitted); *see also SEC v. Kern*, 425 F.3d 143, 153 (2d Cir. 2005).

The Division seeks third-tier penalties. Div. Br. at 58. Specifically, the Division seeks four third-tier penalties for each of the seven quarters between July 21, 2010, and March 2012, based on four categories of violations: false statements and certifications in ALC's periodic filings, false statements to auditors, falsification of ALC's books and records, and execution of a scheme to defraud. *Id.* The Division has proven more than four violations for each of those quarters, and although there was only one scheme, it involved distinct violative acts which recurred quarterly. Counting four units of violation for each quarter prejudices Bebo less than counting the maximum legally available, and I accordingly adopt the Division's request.

The record supports third-tier penalties for each of the four categories of violations. Bebo's conduct involved fraud and/or at least reckless disregard of a regulatory requirement. It resulted in substantial losses to ALC from the settlement of lawsuits. It also created a significant risk of substantial losses to investors, as demonstrated by the 12.36% drop in ALC's stock price on May 4, 2012, at least half of which was likely attributable to the disclosure of the "irregularities" caused by Bebo. Ex. 2186 at 15, Ex. 7.

The public interest factors, on balance, weigh in favor of maximum civil penalties. As noted, all four categories of violations involved fraud and/or at least reckless disregard of a regulatory requirement, and the resulting harm caused substantial losses to ALC and a significant risk of substantial losses to investors. Bebo's misconduct did not clearly benefit her financially,

but it helped her avoid discipline and reputational harm; although this factor does not weigh in favor of a severe penalty, it also does not weigh against it. Bebo has no prior regulatory record. There is unquestionably a need to deter her and others from committing accounting fraud.

As for other matters, the exceptional egregiousness of her misconduct merits reiteration: Bebo abused her position as CEO, she corrupted ALC's internal controls and corporate culture, she betrayed others' trust, she undermined the integrity of the market for ALC securities, and her testimony was often utterly incredible. And all merely to avoid having to admit that the financial covenants had been violated. Four civil penalties will be imposed for each of the seven quarters Bebo committed violations, at the maximum of $150,000, totaling $4.2 million.

E. Officer-and-Director Bar

Section 21C(f) of the Exchange Act authorizes the Commission to prohibit a person who has violated Section 10(b) of the Exchange Act or the regulations thereunder from acting as an officer or director of an issuer, if the conduct of that person demonstrates unfitness to serve as such an officer or director. 15 U.S.C. § 78u-3(f). Unfitness is evaluated in light of six factors which "closely resemble" the *Steadman* factors: (1) the egregiousness of the underlying securities law violation; (2) the defendant's repeat offender status; (3) the defendant's role or position in the fraud; (4) the defendant's degree of scienter; (5) the defendant's economic stake in the violation; and (6) the likelihood that misconduct will recur. *SEC v. Bankosky*, 716 F.3d 45, 47-49 (2d Cir. 2013); *SEC v. Patel*, 61 F.3d 137, 141 (2d Cir. 1995). Although Bebo's direct economic stake in the post-July 21, 2010, violations was not proven, her role in them could not have been more significant; the unfitness factors otherwise yield the same result as the *Steadman* factors. Thus, a permanent officer-and-director bar will be imposed.

VI. RECORD CERTIFICATION

Pursuant to 17 C.F.R. § 201.351(b), I certify that the record includes the items set forth in the Corrected Record Index issued by the Commission's Office of the Secretary on September 30, 2015.

ORDER

It is ORDERED, pursuant to Section 21C of the Securities Exchange Act of 1934, that Respondent Laurie Bebo shall CEASE AND DESIST from committing or causing any violations or future violations of Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Securities Exchange Act of 1934 and Rules 10b-5, 13a-1, 13a-13, 13a-14, 13b2-1, and 13b2-2 thereunder.

It is FURTHER ORDERED, pursuant to Section 21B of the Securities Exchange Act of 1934, that Respondent Laurie Bebo shall pay a CIVIL MONEY PENALTY of $4,200,000.

It is FURTHER ORDERED, pursuant to Section 21C of the Securities Exchange Act of 1934, that Respondent Laurie Bebo is permanently BARRED from acting as an officer or director of any issuer that has a class of securities registered with the Commission pursuant to

Section 12 of the Securities Exchange Act of 1934 or that is required to file reports pursuant to Section 15(d) of the Securities Exchange Act of 1934.

Payment of civil money penalties shall be made no later than twenty-one days following the day this Initial Decision becomes final, unless the Commission directs otherwise. Payment shall be made in one of the following ways: (1) transmitted electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) direct payments from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or (3) by certified check, United States postal money order, or bank cashier's check, payable to the Securities and Exchange Commission.

Any payment by certified check, United States postal money order, or bank cashier's check shall include a cover letter identifying the Respondent and Administrative Proceeding No. 3-16293, and shall be mailed or hand-delivered to: Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Blvd., Oklahoma City, Oklahoma 73169. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then a party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact.

The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

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Cameron Elliot
Administrative Law Judge