



UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING  
File No. 3-17104

In the Matter of

BIOELECTRONICS CORP.,  
IBEX, LLC,  
ST. JOHN'S, LLC,  
ANDREW J. WHELAN,  
KELLY A. WHELAN, CPA, AND  
ROBERT P. BEDWELL, CPA,

Respondents.

**THE DIVISION OF ENFORCEMENT'S POST-HEARING REPLY BRIEF**

Charles D. Stodghill (202) 551-4413  
Paul W. Kisslinger (202) 551-4427  
Sarah H. Concannon (202) 551-5361  
Thomas B. Rogers (202) 551-4776  
U.S. SECURITIES AND EXCHANGE COMMISSION  
100 F Street, N.E.  
Washington, D.C. 20549

*Counsel for the Division of Enforcement*

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## PRELIMINARY STATEMENT

During the five-day hearing and in its Initial Brief, the Division<sup>1</sup> demonstrated that Respondents have a history of ignoring the securities laws to their own advantage. The Division presented overwhelming evidence that Respondents violated Section 5 of the Securities Act and that they have not met their burden of proof with respect to their entitlement to any exemption. The Division also showed that Respondents Andrew Whelan and BIEL violated Section 13 of the Exchange Act and related rules. Nothing in Respondents' Initial Brief ("Resp. Br.") changes this landscape.

There's a saying—if the law is on your side, argue the law; if the facts are on your side, argue the facts. Here, Respondents do neither. Instead, they cast aspersions on the Division's motivations, ignore the clear import of their own sworn testimony, offer conclusory assertions without evidentiary basis, and attempt to play on this Court's sympathies. Respondents' arguments are unavailing. The Division seeks only the outcome required by the facts and the law: Respondents should be held accountable for their repeated and willful violations of the securities laws in the best interests of the investing public.

Registration under Section 5 is not a technicality. A chain of distribution to the public market, such as the one Respondents created here, deprives investors of the information to which they are entitled in a registration statement. Respondents' repeated circumvention of Section 5's registration requirements resulted in billions of shares of BIEL making their way into the hands of investors without registration statements, dramatically diluted BIEL's share value, and denied investors the transparency to know exactly how, and through whom, BioElectronics was funding its day-to-day operations. The Division has met its *prima facie* burden under Section 5.

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<sup>1</sup> Unless otherwise defined, capitalized terms used herein have the same definitions as set forth in the Division's Initial Post-Hearing Brief ("Initial Brief" or "Initial Br.>").



In arguing that their transactions are exempt under Section 5, Respondents parse the exemptions in a manner that is divorced from the objectives of the statute. All the exemptions in Section 4(a) are rooted in the fundamental distinction between *distributions*, such as those by Respondents here, and ordinary trading. “The term ‘distribution’ refers to the entire process in a public offering through which a block of securities is dispersed and ultimately comes to rest in the hand of the investing public.” *Geiger v. SEC*, 363 F.3d 481, 487 (D.C. Cir. 2004). Thus, the registration requirement applies to all sales until the shares come to rest in the hands of independent investors. Here, the securities only came to rest once in the hands of investors who purchased BIEL securities from broker-dealers in the public market and it is *those* investors whom this Court should protect. Respondents have not met their burden to establish that their unregistered transactions were exempt under Section 4(a) or qualified for the safe harbor of Rule 144.

As for Respondents’ arguments concerning BIEL’s purported compliance with Section 13, they have not even attempted to rebut the Division’s showing that the YesDTC and eMarkets transactions failed to comply with multiple elements of revenue recognition under GAAP. Instead, Respondents rely on irrelevant side arguments under the common law and UCC, that, even if true, do not validate the Company’s misstatements in its 2009 10-K. As for Respondents’ threshold argument that BIEL withdrew its registration statement and did not need to comply with Section 13 at all—Respondents simply have misconstrued the law. The Form 8-A registration that BIEL filed in 2006 automatically became effective after 60 days, whether or not the Company was a “voluntary” or “mandatory” registrant.

In arguing remedies, Respondents’ self-serving assertions about what this Court “undoubtedly” concluded concerning their “honesty” and “inadvertent[.]” violations are belied by

the Record. Respondents also attempt in vain to re-assert the good-faith reliance on accountants and counsel defense that this Court explicitly rejected and as to which there is little or no evidence. Respondents then plead for a toothless remedy, arguing that anything other than nominal disgorgement (and no civil penalty) would “impose a financial death sentence on BioElectronics.”<sup>2</sup> But even if this were true—and the evidence does not support Respondents’ dire prediction—inability to pay is merely one factor to be considered as a matter of discretion in administrative proceedings.<sup>3</sup> This Court should consider the remedies necessary and appropriate to protect not just current BIEL shareholders, but future investors as well. Despite the gravity of their violations, Respondents continue to show no appreciation for the need to make required disclosures and to keep accurate books and records. Thus, there is no reason to believe that Respondents will not continue to engage in the very conduct at issue in this case unless this Court orders them to stop.

This Court should find that: (i) Respondents violated Section 5 of the Securities Act; (ii) Andrew and Kelly Whelan’s violations of Section 5 were willful; and (iii) Andrew Whelan and BIEL violated Section 13 of the Exchange Act and related rules, and award appropriate relief, including relief that takes into consideration Respondents’ failure to recognize that the *status quo*, and their willful violations, cannot be tolerated.

## ARGUMENT

### I. RESPONDENTS HAVE NOT MET THEIR BURDEN OF PROOF WITH RESPECT TO ANY EXEMPTION TO SECTION 5

In its Initial Brief, the Division detailed its *prima facie* showing under Section 5, described the exemptions thereto (which are construed narrowly in favor of registration), and

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<sup>2</sup> Resp. Br. at 58.

<sup>3</sup> 17 C.F.R. § 630.

showed that Respondents cannot meet their burden of proof to show an exemption.

Respondents' post-hearing arguments do not change the necessary outcome of this case.

**A. BIEL's Sales to IBEX and St. John's Are Not Exempt Under Section 4(a)(2)**

Respondents argue that BIEL's sales to IBEX and St. John's are exempt under Section 4(a)(2) because they "were not a public offering."<sup>4</sup> This argument improperly severs the first piece of Respondents' chain of distribution of BIEL securities to the public from the remainder of the chain, and asks this Court to turn a blind eye to everything that came thereafter.

Respondents' argument also ignores Congressional objectives of Section 5, which require registration when securities are distributed to the public by the issuer or a control person, and when securities are distributed to the public through intermediaries who buy with a view to public resale or sell for the issuer or control person. *Geiger*, 363 F.3d at 487 ("[D]istribution refers to the *entire process* in a public offering") (emphasis added); *see also SEC v. Murphy*, 626 F.2d 633, 641 (9th Cir. 1980) (Section 4(a)(2) is construed narrowly in furtherance of the Securities Act's purpose). Respondents also disregard the wealth of decisions in which courts have considered the totality of circumstances through which securities emanating from an issuer make their way into the public market through multiple layers of conduits in transactions that are structured to break the chain of a distribution.<sup>5</sup>

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<sup>4</sup> Resp. Br. at 16.

<sup>5</sup> "The Supreme Court has long instructed that securities law places emphasis on economic reality and disregards form for substance." *SEC v. M&A West, Inc.*, 538 F.3d 1043, 1053 (9th Cir. 2008) (dismissing creative sequencing of agreements designed by defendant to create "loophole" under Rule 144); *see also Zacharias v. SEC*, 569 F.3d 458, 463 (D.C. Cir. 2009) (affirming the Commission's decision to view multiple transactional steps as necessary steps of an overall plan of distribution as "a triumph of substance over form"); *SEC v. Kern*, 425 F.3d 143, 153 (2d Cir. 2005) ("Cutting off liability partway through a distribution by a control person would permit a control person to retain some fraction of the profits from such a distribution, thereby encouraging sales made without proper disclosures—precisely the result that *Ralston Purina* instructs us to avoid in interpreting exemptions.").

Here, BIEL's transactions with IBEX and St. John's are the first and essential step in one continuous offering to the public, carried out through intermediaries. As the issuer, BIEL cannot hide behind Section 4(a)(2) when it knew that securities converted and transferred to IBEX and St. John's were being resold into the market and knew that IBEX's "loans" to BIEL were funded by these public distributions. Under the circumstances of this case, allowing Respondents to find shelter under Section 4(a)(2) would eviscerate Section 5's intent to ensure that issuers, like BIEL, provide investors with the information to which they are entitled in a registration statement before the issuer seeks to raise money through public investment.<sup>6</sup>

**B. IBEX's Sales to the Liquidating Entities Are Not Exempt Under Section 4(a)(1)**

Respondents argue that IBEX's sales were exempt under Section 4(a)(1), because IBEX: (i) is not an "issuer, underwriter or dealer," (ii) was not an affiliate of BIEL or under common control with BIEL; and (iii) met the requirements of Rule 144 for sales by non-affiliates.<sup>7</sup> Each of these arguments fails.

**1. IBEX Has Not Shown That It May Rely on Section 4(a)(1)**

Respondents argue that IBEX is entitled to the protections of Section 4(a)(1), because it was not an issuer, underwriter, or dealer. As an initial matter, to the extent IBEX and Kelly Whelan believe that they can avoid liability if IBEX was not itself an issuer, underwriter, or dealer, that is not the law. Liability follows for *all* participants in any unregistered offering that *involves* underwriters.<sup>8</sup> Moreover, the evidence, far from showing Respondents' entitlement to the Section 4(a)(1) exemption, shows that IBEX does not meet the statutory criteria. *See SEC v.*

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<sup>6</sup> See Initial Br. at 47-50.

<sup>7</sup> Resp. Br. § III.A.

<sup>8</sup> Initial Br. at 37-39, 46-50.

*Ralston Purina Co.*, 346 U.S. 119, 126 (1953) (“Keeping in mind the broadly remedial purposes of federal securities legislation, imposition of the burden of proof on an issuer who would plead the exemption seems to us fair and reasonable.”); *SEC v. Cavanagh*, 445 F.3d 105, 111 n.13 (2d Cir. 2006) (“Once a *prima facie* case has been made, the defendant bears the burden of proving the applicability of an exemption.”).

First, Respondents’ assertion that “[t]he Division does not and cannot contend that IBEX was an issuer,”<sup>9</sup> elevates linguistic simplicity over substantive reality. The Division does not suggest that IBEX was the issuer as defined in Section 2(a)(4) of the Act—BIEL was. But the Division does argue—and demonstrated at the hearing—that IBEX: (i) sold for the *issuer*; (ii) is an affiliate and part of BIEL’s control group that is included as an *issuer* for purposes of the definition of “underwriter” in Section 2(a)(11); and (iii) participated in a public distribution of the *issuer*’s securities.<sup>10</sup> IBEX’s transactions involved underwriters, and IBEX cannot meet its burden of showing an exemption under Section 4(a)(1).

Second, Respondents contend that IBEX has met its burden of proof to show that it is not itself an underwriter under Section 4(a)(1), because “IBEX was at risk for its investments in BioElectronics for more than one year,” and because it “reinvested” in BIEL.<sup>11</sup> Respondents then suggest that even if IBEX did not meet Rule 144’s stringent requirements, this Court nevertheless may find that IBEX is exempt because it was not an underwriter.<sup>12</sup> However this Court approaches the question, though, IBEX’s evidence that it was not the affiliated financing arm of BIEL and part of BIEL’s control group—which sold for the issuer and participated in

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<sup>9</sup> Resp. Br. at 16.

<sup>10</sup> Initial Br. at 40-47.

<sup>11</sup> Resp. Br. at 16-17.

<sup>12</sup> Resp. Br. at 18.

distributions of BIEL’s securities—is not convincing. Rather, the evidence shows the exact opposite; IBEX’s transactions are not exempt.

Finally, this Court previously has asked whether IBEX is a “dealer.”<sup>13</sup> The Court need not reach this question, however, because it is clear that IBEX is not entitled to an exemption under Section 4(a)(1). Should the Court consider whether IBEX is a dealer, however, there is substantial evidence in the Record from which the Court can conclude that IBEX and Kelly Whelan “engage[d] either for all or part of [their] time, directly or indirectly, as agent, broker, or principal in the offering, buying, selling or otherwise dealing or trading in securities issued by another person.”<sup>14</sup>

## **2. IBEX is an Affiliate of BIEL and Part of BIEL’s Control Group**

Respondents contend that “IBEX is not an affiliate,” because BIEL and IBEX were not “under common control,” and because “there was no actual power at play.”<sup>15</sup> The Record proves the contrary.

In its Initial Brief, the Division detailed the copious evidence establishing that IBEX is the affiliated financing arm of BIEL and part of BIEL’s control group.<sup>16</sup> That evidence establishes that neither the Section 4(a)(1) exemption nor the Rule 144 safe harbor is available. Respondents’ arguments do not change this conclusion.

First, Respondents erroneously advance an overly-narrow interpretation of “control,” arguing—based on the trial court decision, *United States v. Wolfson*, 269 F. Supp. 621 (S.D.N.Y.

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<sup>13</sup> Tr. 106:15-17; Order Denying Motions for Summary Disposition at 5 (July 26, 2016) (“Summ. Disp. Order”).

<sup>14</sup> 15 U.S.C. § 77b(a)(12); see also *In the Matter of Donald J. Anthony, Jr. et al.*, AP File No. 3-15514, 2015 SEC LEXIS 707, at \*258, n.111 (Feb. 25, 2015) (discussing the “expansive” definition of dealer under Section 77b(a)(12)).

<sup>15</sup> Resp. Br. at 20.

<sup>16</sup> Initial Br. at 8-10, 40-45.

1967)—that “[c]ontrol persons are generally officers, directors and/or larger shareholders of the issuer,” and suggesting that since Kelly Whelan held none of those positions, she was not a member of the control group at BIEL.<sup>17</sup> But the *Wolfson* trial court did not say what Respondents say it did. And, in any event, the Second Circuit held on appeal:

Gerbert was a director of Continental. Wolfson was not, nor was he an officer, but there is ample evidence that nevertheless as the largest individual shareholder *he was Continental’s guiding spirit* in that the officers of the corporation were subject to his direction and control and that *no corporate policy decisions were made without his knowledge and consent*. Indeed Wolfson admitted as much on the stand.

*United States v. Wolfson*, 405 F.2d 779, 781 (2d Cir. 1968) (emphasis added). Thus, the relevant question in *Wolfson* was not legal ownership or control, but rather the level of the defendant’s actual influence. Likewise, *United States v. Sherwood*, 175 F. Supp. 480 (S.D.N.Y. 1959), on which Respondents also rely, does not stand for the proposition that an “8% stockholder did not have the power to control the issuer.”<sup>18</sup> Rather, like *Wolfson*, *Sherwood* articulates a facts and circumstances test that does not turn on the legal status of an individual as an officer, director, or large shareholder. 175 F. Supp. at 483 (“[A]lthough Sherwood dominated 8% of the total issued stock, he was *unable* to secure a representation on the board of directors, he had a falling-out with ... the dominant figure in the management of [the company], and Sherwood was *unable* to sell the bulk of his shares for distribution until [management] consented thereto.”) (emphasis added). Here, the facts and circumstances detailed in the Division’s Initial Brief show that IBEX was an affiliate of BIEL and part of BIEL’s control group, capable of making BIEL’s Board of Directors take action, including through the authorization of new shares.<sup>19</sup> Moreover, even using

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<sup>17</sup> Resp. Br. at 21 (citing *Wolfson*, 269 F. Supp. at 626).

<sup>18</sup> *Id.*

<sup>19</sup> Initial Br. at 8-10, 40-45.

the narrow test proffered by Respondents, at certain points during the Relevant Period, had IBEX converted its notes, it would have held a substantial percentage of BIEL's total shares outstanding.<sup>20</sup>

Second, Respondents rely on the "expert" report of Richard Staelin, BIEL's Chairman of the Board and sole member of the Audit Committee, and a portion of Mr. Staelin's hearing testimony.<sup>21</sup> This Court already has stated that it does not intend to place any weight on Mr. Staelin's report,<sup>22</sup> and Mr. Staelin's generalized opinions on power and control have nothing to do with the meaning of "affiliate" and "control" under Rule 144.<sup>23</sup> But even adopting, *arguendo*, Mr. Staelin's description of power and control—"Person A has power over Person B to the extent A can get B to do something that B would not otherwise do."<sup>24</sup>—IBEX and Kelly Whelan had the power to direct the management and policies of BIEL and to cause BIEL's Board to take action (*e.g.*, to authorize new shares of BIEL) that it otherwise would not take.<sup>25</sup>

Third, Respondents argue that "[t]he Division hangs its case on the fact that Kelly Whelan never refused a BIEL loan," and (relying on yet another unaccepted expert report) insist that "that proves only that Kelly Whelan believed each loan offered by BIEL would be profitable

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<sup>20</sup> Park Report [DX 137] ¶ 32 (testifying that "[i]f the remaining balance of the Revolver Note debt had all been converted at the end of March [2013], the total shares outstanding would have increased to over 4 billion shares with approximately 30% of that issued to IBEX.") (emphasis added).

<sup>21</sup> Resp. Br. at 21 (citing RX 202, Tr. 1258-59 (Staelin)).

<sup>22</sup> Tr. 35:7-9.

<sup>23</sup> In light of this Court's instruction, during the hearing the Division did not examine Mr. Staelin on his expert qualifications or the opinions offered in his report. Mr. Staelin admitted during his investigative testimony, however, that he is not a securities expert and is unfamiliar with Rule 144.

<sup>24</sup> Expert Report of Richard Staelin at 002401 [RX 202].

<sup>25</sup> See Initial Br. at 43 (citing *SEC v. Franklin Atlas Corp.*, 154 F. Supp. 395, 400-01 (S.D.N.Y. 1957)).



for IBEX.”<sup>26</sup> But the Division does not “hang[] its case” on any single piece of evidence.

Rather, the Division has shown that the evidence, taken as a whole, establishes that IBEX was part of BIEL’s control group.<sup>27</sup>

Thus, this Court does not need to cherry-pick from among the host of facts establishing that IBEX is an affiliate of BIEL. But if it were to do so, the pivotal fact is Respondents’ failure to establish that Kelly Whelan and IBEX could not have required BIEL to seek registration.<sup>28</sup> Although Respondents argue that Andrew Whelan would have refused a registration demand by IBEX, and that Kelly Whelan never demanded registration,<sup>29</sup> Kelly Whelan and IBEX, at all times, had the power to require registration. IBEX could have demanded, as a requirement of its financing, that BIEL register. Because BIEL struggled to find independent financing, it very likely would have capitulated to that demand. But if it did not, IBEX had the power to withdraw its financing and, ultimately, leave the Company without the money it needed to pay for its operations. The fact that Kelly Whelan never exercised this power is just further evidence that she was a “friendly lender” and an affiliated part of BIEL’s control group.<sup>30</sup>

In sum, the facts and circumstances establish that the relationship between BIEL and IBEX is not that of buyer-purchaser, but rather that of a friendly lender, whereby *both* parties succeed through joint enterprise. Purchasers of BIEL shares from IBEX were not purchasing from a disinterested long-term investor, but rather from a lender that needed to cover its loan, and the proceeds of the sales were returned to the issuer to fund its operations.

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<sup>26</sup> Resp. Br. at 21 (citing Expert Report of David Robinson [RX 201]).

<sup>27</sup> See Initial Br. at 8-10, 40-45.

<sup>28</sup> *Id.* at 43-44.

<sup>29</sup> Resp. Br. at 14.

<sup>30</sup> Initial Br. at 42-45.

Fourth, Respondents' reliance on their own self-serving and conclusory hearing testimony that BIEL did not control IBEX and IBEX did not control BIEL does not carry their burden of proof.<sup>31</sup> Respondents' arguments are inconsistent with the actual facts, including other portions of their own testimony.

Fifth, contrary to Respondents' repeated refrain that the Division relies on a "sexist" theory that Kelly Whelan is controlled by Andrew Whelan because she is his daughter, the Division has advanced no such argument.<sup>32</sup> Again, the Division demonstrated that it was Kelly Whelan's ability (among other things) to put BIEL out of business and to require BIEL's Board of Directors to vote to create new shares of BIEL that establishes *her* shared control over BIEL and that *she* is part of BIEL's control group.

Sixth, Respondents mischaracterize the Division's argument when they assert that "[t]he Division contends that because Kelly Whelan did some accounting work as an independent contractor for BioElectronics, they were under common control."<sup>33</sup> Kelly Whelan has had an intimate relationship with BIEL for years, including not only "some accounting work," but also participation in BIEL Board meetings and on BIEL Board communications, a BIEL email address, posting on behalf of BIEL to social media sites, and acting as a BIEL distributor in Canada up to the present.<sup>34</sup> These facts, in combination with all of the other evidence, are highly probative of affiliate status.

Finally, Respondents argue that Kelly Whelan's security interest over all of the assets of BIEL does not establish control, because "the power to enforce such security interest would only

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<sup>31</sup> Resp. Br. at 22.

<sup>32</sup> *Id.* at 22-23.

<sup>33</sup> *Id.* at 23.

<sup>34</sup> Tr. 417:7-418:16, 438:23-439:3, 1062:8-1063:1 (K. Whelan); Tr. 884:11-14, 887:13-16 (A. Whelan); *see also* Initial Br. at 8-10, 41-42.

arise upon default,” and “the note was subordinated to the senior secured lien in favor of the United States’ XM [*sic*]/Bank loan.<sup>35</sup> Respondents’ arguments ignore two crucial facts: (1) Kelly Whelan had the power to force BIEL into default by requiring payment of her notes when they came due, rather than renegotiating their terms or selling them to third-party purchasers; and (2) Ms. Whelan’s willingness to subordinate her security interest to that of another lender without, apparently, receiving anything in exchange, was not in *IBEX*’s interest, but in the interest of *BIEL*. This further evidences the shared control relationship among Respondents and *IBEX*’s affiliate status.<sup>36</sup>

The weight of the evidence makes clear that *IBEX* was an affiliate of *BIEL* and part of *BIEL*’s control group. As such, *IBEX* cannot avail itself of the Section 4(a)(1) exemption, because *IBEX* was sharing control with *BIEL*, the issuer, meaning that anyone acquiring or selling securities held by *IBEX* was acting as an underwriter in a distribution of securities by the issuer.<sup>37</sup>

### 3. *IBEX*’s Sales Are Not Within Rule 144’s Safe Harbor

Respondents next argue that *IBEX* satisfied Rule 144, but this argument depends entirely on Respondents’ incorrect premise that *IBEX* was *not* an affiliate and *not* selling restricted securities.<sup>38</sup> If this Court finds—as it should—that *IBEX* is an affiliate of *BIEL*, then it need not reach the question of holding periods at all, because it is undisputed that *IBEX* did not comply with Rule 144’s stringent requirements for sales of restricted securities by affiliates.<sup>39</sup> Among

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<sup>35</sup> Resp. Br. at 23.

<sup>36</sup> See Initial Br. at 8-10, 41-42.

<sup>37</sup> *Id.* at 39-40, 46-47; see also *SEC v. Culpepper*, 270 F.2d 241, 245-46 (2d Cir. 1959).

<sup>38</sup> See Resp. Br. at 24-27 (arguing that *IBEX* satisfied Rule 144 provisions that govern sales by *non-affiliates*).

<sup>39</sup> Initial Br. at 45.

other problems, IBEX's sales exceeded, and at times, grossly exceeded, Rule 144's volume limitations for affiliate sales.<sup>40</sup> IBEX also did not file Forms 144 with the Commission disclosing its affiliate sales. For these reasons, IBEX is not entitled to Rule 144's safe harbor for sales by affiliates, and this Court need go no further.

But even if this Court reaches the question of holding periods, Respondents' argument that IBEX satisfied them is unavailing.

First and foremost, although Respondents argue that the Division's approach to holding periods "defies the purposes of Section 4 and Rule 144," is "unsupportable and illogical," and is "baseless,"<sup>41</sup> it is Respondents, not the Division, that ask this Court to ignore the legislative intent and purpose of Section 5, Section 4, and Rule 144. Registration is the cornerstone of the Securities Act, and exemptions to Section 5 are construed narrowly. Congress distinguished between distributions of securities and ordinary trading in order to require registration where issuers are raising capital through sales in the public markets (where investors indisputably are entitled to the transparency provided by a registration statement), but to permit secondary trading amongst private investors once securities have legitimately entered the marketplace. *Geiger*, 363 F.3d at 487; *Ackerberg v. Johnson*, 892 F.2d 1328,1328 (8th Cir. 1989).

Respondents' holding period argument elevates form over substance. Although it often might be the case that if a purchaser holds its stock for an extended period of time before selling,

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<sup>40</sup> See, e.g., Park Report [DX 137] ¶¶ 16, 19-20, 67. Rule 144's volume limitations on sales of an issuer's securities by affiliates are paramount. Rule 144 permits affiliates to sell *limited* quantities of restricted securities because such quantities do not impact the market or equate to a wide distribution to public investors where registration is most important. Rule 144's volume limitations are thus a proxy for the line between a public offering and sales by affiliates that do not require information to be disseminated to investors through a registration statement. Limited quantities also serve to distinguish between sales for the issuer and sales by those in a control relationship with the issuer but who are not selling as part of a distribution.

<sup>41</sup> Resp. Br. at 25-26.

it is suggestive of ordinary trading, not distribution, that falls apart where the purchaser is repeatedly an essential part of the issuer's chain of distribution to the market. Here, IBEX is simply a conduit for the delivery of BIEL shares to the market, and the securities at issue did not "come to rest" until they landed in the hands of the investing public and IBEX round-tripped the majority of the proceeds of its sales back to BIEL. In other words, IBEX was selling for the issuer, BIEL, and when IBEX made "investments" in BIEL, it did so with a view toward selling the convertible notes received in exchange to the public.<sup>42</sup> Under these facts and circumstances, to find that IBEX is entitled to Rule 144's safe harbor would be to elevate form over substance, in violation of the intent of the Securities Act. *See, e.g., SEC v. Platforms Wireless Int'l Corp.*, 617 F.3d 1072, 1085 (9th Cir. 2010) ("We are concerned with whether *in substance* [Defendant] issued its securities to the public without a registration or exemption.") (emphasis added).

Second, Respondents' holding period speaks only to *one* of the underwriter definitions—whether IBEX purchased securities from BIEL "with a view to" distribution—where lengthy holding periods are suggestive of purchasing with investment intent. But Respondents' argument ignores the fact that liability *also* arises under Section 5 if IBEX "sold for the issuer," "participated in transactions with underwriters," or was an indispensable participant in the issuer's chain of distribution. Under each of these tests, IBEX's holding periods are irrelevant.<sup>43</sup>

Third, Respondents argue that "[t]o calculate correctly an investor's holding period, it is necessary to ascertain precisely when the period begins," and assert that "[t]he SEC has interpreted 'date of acquisition' to start when the full risk of economic loss was assumed by the

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<sup>42</sup> Tr. 171:4-10 (Park: "They were liquidating securities here when they needed to raise funds for the issuer. So again, looking at it again, I can't stress enough that the facts and circumstances surround an underwriter, whether they—and how they were acting as an underwriter, including selling for an issuer."); *see also* Initial Br. at 39-40, 45-46.

<sup>43</sup> Initial Br. Law & Argument § I.B.1.b & d.

transferee.”<sup>44</sup> But even under Respondents’ argument, it is far from clear when the period begins or when IBEX assumed “the full risk of economic loss.”<sup>45</sup> In calculating IBEX’s holding periods, Mr. Flood relied on a back-dated convertible promissory note and unauthenticated records of Kelly Whelan’s tax accountant. Kelly Whelan’s documentation of loans to BIEL and notes received in exchange is dubious,<sup>46</sup> and, because of her reinvestment in BIEL, Kelly Whelan immediately replaced the vast majority of notes sold with *new* notes, meaning that her “investment risk” was nominal.<sup>47</sup>

Fourth, Respondents mischaracterize the Division’s position, arguing that “[t]he Division, through Mr. Park, ignores the text of Rule 144 and the undisputed multi-year holding periods of securities sold by IBEX, and instead focuses its analysis on the holding period of sales proceeds—the time that IBEX held the cash after selling ... BioElectronics’ securities, and before IBEX reinvested the proceeds of that sale in BioElectronics.”<sup>48</sup> The Division’s position is that holding periods are irrelevant, because IBEX’s sales of BIEL securities to third parties were inextricably conjoined with IBEX’s round-tripping of the sale proceeds back to BIEL. IBEX sold for the issuer and is an underwriter.<sup>49</sup>

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<sup>44</sup> Resp. Br. at 24 (relying on Rule 144(d)(3)(ii) and arguing that IBEX’s two-year holding period began upon the making of a convertible loan).

<sup>45</sup> See Initial Br. at 21-23.

<sup>46</sup> Respondents themselves admit that “[p]rior to August 2009, IBEX loaned to BioElectronics under the terms of convertible notes issued to third parties, but without formal execution of separate notes between IBEX and BioElectronics.” Resp. Br. at 25. This is nonsensical. An oral, undocumented agreement between BIEL and IBEX cannot result in a convertible note. Although the parties might agree to memorialize their oral agreement after-the-fact, such a memorialization is incapable of creating a convertible “note” (*i.e.*, a security).

<sup>47</sup> See Initial Br. at 21-23; see also *id.* at 18 (citing Park Report [DX 137] at 27).

<sup>48</sup> Resp. Br. at 25 (citing entire Park report).

<sup>49</sup> Respondents’ other arguments merit little attention. Respondents argue that “the Division’s unsupportable and illogical approach would undermine the purpose of the safe harbor

Thus, if this Court finds, as the evidence supports, that Respondents engaged in a multi-year plan to fund BIEL's operations through distributions to the public in unregistered transactions, then Rule 144's safe harbor is unavailable. Respondents implore this Court to "leave the lawmaking to the lawmakers, not the enforcement staff."<sup>50</sup> Far from arguing for new law, the Division's position is amply supported by long-standing law.

**C. Section 4(a)(7) Does Not Provide an Exemption for IBEX's Sales of BIEL Securities**

Respondents next raise (for the first time in this proceeding) the surprising argument that "newly enacted Section 4(a)(7) provides an exemption for all IBEX resales of BioElectronics securities."<sup>51</sup> It is unclear whether Respondents intend to argue that IBEX's sales *are exempt* under Section 4(a)(7),<sup>52</sup> or whether they are merely arguing that Section 4(a)(7) is indicative of

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provision—to encourage capital investment in start-up companies—upon which economic growth and prosperity rely." Resp. Br. at 26. But investors in start-up publicly traded companies rely on registration statements to decide where to make their capital investments.

Likewise, Respondents argue that "[i]f the enforcement Division's baseless approach is adopted into law by this Court ... investors would be punished for reinvesting funds into an issuer, potentially with a judgement requiring them to disgorge the proceeds of their investments, plus penalties and injunctive relief." *Id.* Requiring Respondents to comply with Section 5's registration requirements *informs* investors, not "punish[es]" them. Respondents again place their own self-interests above the rights of public investors.

Finally, Respondents accuse the division of "short-sighted and unbridled advocacy." *Id.* Congress, in enacting the Securities Act, was neither short-sighted nor unbridled. The legislative scheme constructed by Congress in Section 5, Section 4(a), and Rule 144 precludes Respondents' arguments here. Congress was careful to preempt all circumventions of registration where, as here, registration is essential to providing investors with relevant information before they decide to invest.

<sup>50</sup> Resp. Br. at 26.

<sup>51</sup> *Id.* at 27.

<sup>52</sup> *Id.* at 27-29, 60.

legislative intent and that its sales *would have been* exempt had Section 4(a)(7) existed during the Relevant Period.<sup>53</sup> Either way, though, Respondents cannot rely on Section 4(a)(7).

On December 4, 2015, President Obama signed into law the Fixing America Surface Transportation Act (the “FAST Act”). Pub. L. No. 114-94, 129 Stat. 1312 (Dec. 4, 2015). Although the FAST Act deals primarily with transportation funding,<sup>54</sup> it also made several changes to the Securities Act, including through the enactment of Section 4(a)(7), a new exemption from registration requirements for private resales of restricted and control securities to accredited investors. 15 U.S.C. § 77d(a)(7).<sup>55</sup> Since Section 4(a)(7) did not exist during the Relevant Period, IBEX cannot rely on this exemption.

To the extent Respondents suggest that the newly-enacted Section 4(a)(7) liberalizes Section 5’s registration requirements to permit distributions such as those at issue here, this is an incorrect reading of the Section and its legislative history. Section 4(a)(7) is, essentially, a non-exclusive safe harbor for private resales previously falling under the so-called “Section 4(a)(1 ½) exemption, much like Rule 506 of Regulation D operates as a safe harbor for private issuer sales under Section 4(a)(2) of the Securities Act.<sup>56</sup> As the Division explained in its Initial Brief, IBEX is an affiliate of BIEL that sold for the issuer through the Liquidating Entities and broker-dealers (*i.e.*, underwriters) in what amounts to a distribution.<sup>57</sup> Because IBEX’s distributions of BIEL

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<sup>53</sup> *Id.* at 35.

<sup>54</sup> See U.S. Dep’t of Transportation, The Fixing America’s Surface Transportation Act or “Fast Act,” *available at* <https://www.transportation.gov/fastact>.

<sup>55</sup> See David A. Lipton, Adoption of the Fixing America’s Surface Transportation Act (the Fast Act) and Its Impact on the Securities Act of 1933, 15 Broker-Dealer Reg. § 1.32.55 (July 2016).

<sup>56</sup> See Lipton, *supra*, note 55.

<sup>57</sup> Initial Br. at 40-47.



securities involved underwriters, its sales are not exempt under Section 4(a)(1 ½).<sup>58</sup> For the same reason (although no Court appears to have reached this precise question in the months since its enactment), Section 4(a)(7) would not exempt IBEX's sales either, because they are not "private sales," but rather are public distributions involving underwriters.

Moreover, even if Section 4(a)(7) could somehow apply, Respondents did not present evidence during the hearing directed at establishing the required factual predicate. In their brief, Respondents simply recite Section 4(a)(7)'s safe harbor statutory language and rely exclusively on their own testimony that Redwood Management and other IBEX purchasers were "accredited investors."<sup>59</sup>

Respondents improperly ignore the other substantive requirements of the Section 4(a)(7) exemption. Among other things, Section 4(a)(7)(d)(3)(J) requires the seller to make available to the purchaser specified information about the issuer, including "[t]he issuer's most recent balance sheet and profit and loss statement and similar financial statements ... prepared in accordance with generally accepted accounting principles."<sup>60</sup> As such, the requirements of this exemption reflect the need for purchasers to have such information as a registration statement would include which, if provided in the specified manner, is deemed an adequate substitution for registration. Respondents made no showing as to what information, if any, was provided to purchasers from IBEX, other than attorney opinion letters that misrepresented IBEX's affiliate status.

More importantly, Section 4(a)(7)(d)(3)(K) states:

To the extent that the seller is a *control person with respect to the*

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<sup>58</sup> *Id.* at 46-47 (citing *Zacharias v. SEC*, 569 F.3d 458, 464 (D.C. Cir. 2009)).

<sup>59</sup> Resp. Br. at 27-29.

<sup>60</sup> 15 U.S.C. § 77d(a)(7)(d)(3)(J).

*issuer*, a brief statement regarding the *nature of the affiliation*, and a statement certified by such seller that they have no reasonable grounds to believe that the issuer is in violation of the securities laws or regulations.<sup>61</sup>

IBEX definitively did *not* provide any accurate statements regarding the nature of its relationship with BIEL or statements regarding BIEL's compliance with securities laws and regulations.

Respondents likewise adduce no evidence as to Section 4(a)(7)'s "general advertising or solicitation," "redistribution," or contemporaneous information prongs.<sup>62</sup>

Further, even Respondents' focus on IBEX's purchasers' accredited status is misplaced. Section 4(a)(7) exempts sales to "accredited investors" as that term is defined in 17 U.S.C. § 230.501(a).<sup>63</sup> Respondents assert that *one* of IBEX's buyers, Redwood Management, was an accredited investor, and suggest that "some" of IBEX's other buyers "made express representations and warranties as to their sophistication in the contracts with IBEX."<sup>64</sup> This argument is wholly insufficient to establish that *each* person or entity that purchased from IBEX was an accredited investor under Section 230.501(a).<sup>65</sup> And, IBEX's liability here stems not from its failure to verify that the Liquidating Entities were accredited investors, but rather from its misrepresentation that it was not an affiliate and that it was transferring "free-trading" securities.<sup>66</sup> Respondents' misguided attempt to shoe-horn IBEX's sales into an

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<sup>61</sup> 15 U.S.C. § 77d(a)(7)(d)(3)(K) (emphasis added).

<sup>62</sup> 15 U.S.C. § 77d(a)(7)(d)(2) & (7).

<sup>63</sup> 15 U.S.C. § 77d(a)(7)(d)(1).

<sup>64</sup> Resp. Br. at 29.

<sup>65</sup> *Cf. In the Matter of Joseph P. Doxey et al.*, AP File No. 3-15619, 2014 SEC LEXIS 1668, at \*51 (May 15, 2014) ("[T]here is no evidence that [purchaser] was an accredited investor, and [seller] admits as much, foreclosing the ability to claim the Rule 504(b)(1)(iii) exemption.").

<sup>66</sup> Respondents argue, in a footnote, that "[t]here is no evidence whatsoever that any of the purchasers of IBEX shares were in the business of liquidating securities, much less that they had held themselves out to be liquidators of securities to IBEX or anyone else or that BioElectronics

exemption that did not exist at the time of its distributions is unavailing.

**D. St. John's is Not Entitled to Rule 144's Safe Harbor**

Despite St. John's admitted failure to comply with *two* of Rule 144's stringent requirements for sales of an issuer's stock by an affiliate,<sup>67</sup> Respondents nevertheless argue that St. John's sales were exempt under Section 4(a)(1).<sup>68</sup> This is incorrect. Rule 144's safe harbor is "precisely limited to its terms." *SEC v. Kern*, 425 F.3d 143, 147 (2d Cir. 2005); *Platforms Wireless*, 617 F.3d at 1090. Although Rule 144 is a "non-exclusive safe harbor,"<sup>69</sup> the burden of proof on an affiliate, like St. John's, that "falls short" of Rule 144's terms is exacting, and has not been met by Respondents here.

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knew when and in what volumes BioElectronics stock had been sold by the so-called Liquidating Entities ...." Resp. Br. at 29 n.2. This is puzzling since Respondents' *own testimony* establishes these facts:

- Kelly Whelan twice testified that Redwood was in the business of buying debt, converting it, and selling to the market. Tr.491:6-492:9 (K. Whelan). Ms. Whelan also testified that Redwood Management had access to the markets that she did not during the period of the DTC chill. *Id.*
- Andrew Whelan and the other members of BIEL's Board acknowledged that the Board had to authorize sufficient shares for the Liquidating Entities' conversions, and Mr. Whelan sent dozens of letters to BIEL's transfer agent instructing it to issue shares to Redwood and other purchasers without restrictive legends, enabling them to sell to the market. Initial Br. at 12-16.
- BIEL's own unaudited financial reports acknowledged that many purchasers from IBEX would immediately convert and sell. *See, e.g.*, BioElectronics OTC Markets Annual Disclosure (Dec. 31, 2014) at 001642-43 [RX 171M] ("These increases [in number of authorized shares] are a result of the continued requirement to cover the potential issuance of common stock resulting from the conversion of debt to equity. The holders of the remaining shares to be issued upon conversion or exercise of equity instruments are likely to promptly sell those shares into the public market."); *see also* Initial Br. at 13-17, 19-23.

<sup>67</sup> In addition to St. John's failure to file timely Forms 144, Respondents admit that St. John's did not comply with Rule 144's volume limitations for two of seven trading days (nine of 17 transactions). Resp. Br. at 31; Initial Br. at 16-17; 50-51; Joint Stip. ¶ 35 [DX 1].

<sup>68</sup> Resp. Br. at 29-31.

<sup>69</sup> *Id.* at 32 (quoting *Cavanagh*, 445 F.3d at 114).

As the SEC Release announcing Rule 144's adoption warned:

persons who offer or sell restricted securities without complying with Rule 144 are hereby put on notice by the Commission that in view of the broad remedial purposes of the Act and of public policy which strongly supports registration, they will have a substantial burden of proof in establishing that an exemption from registration is available for such offers or sales and that such persons and the brokers and other persons who participate in the transactions do so at their risk.<sup>70</sup>

Thus, once outside the Rule 144 safe harbor, "each Rule 144 alternative" available to St. John's "carries substantial risks."<sup>71</sup>

St. John's has not met its burden of proving entitlement to an exemption under Section 4(a)(1). Because St. John's is, *by definition*, an affiliate of BIEL, it is the issuer for purposes of the Section 4(a)(1) underwriter analysis.<sup>72</sup> Here, St. John's, a control person of the issuer, sold to broker-dealers, which sold to the public.<sup>73</sup> Thus, under Section 2(a)(11), St. John's was an "issuer," and the broker-dealers that sold on behalf of St. John's were "underwriters" selling for the issuer or its control person. St. John's transactions are not exempt under Section 4(a)(1).<sup>74</sup>

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<sup>70</sup> Notice of Adoption of Rule 144, 1933 Act Release No. 33-5223, Fed. Sec. L. Rep.(CCH) ¶ 78,487, at 81,050 (Jan. 11, 1972) (emphases added); *see also Gryl ex rel. Shire Pharms. Group PLC v. Shire Pharms. Group PLC*, 298 F.3d 136, 145 n. 8 (2d Cir. 2002) (an SEC release "is connected to the agency's rule-making function" and thus receives deference under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 [] (1984).").

<sup>71</sup> Stuart R. Cohn, *Securities Counseling for New and Developing Companies* § 14:7 (2005).

<sup>72</sup> 17 C.F.R. § 230.144.

<sup>73</sup> Joint Stip. ¶¶ 34-35 [DX 1]; St. John's Brokerage Statement [RX 196].

<sup>74</sup> *See* 15 U.S.C. § 77d(a)(1) (the registration requirements of Section 5 do not apply to "transactions by any person *other than* an issuer, underwriter, or dealer") (emphasis added).

**E. “Imperfect Compliance” with Rule 144 is Not Enough**

For the same reason, Respondents’ argument that IBEX’s “imperfect compliance” with Rule 144 does not “void [the] Section 4(a)(1) exemption,”<sup>75</sup> is nonsensical. IBEX is an affiliate and part of the issuer’s control group that sold in underwriter transactions.<sup>76</sup> Thus, IBEX fails to establish its entitlement to either Section 4(a)(1) or Rule 144.

Contrary to Respondents’ assertion, IBEX’s holding periods are irrelevant to the Section 4(a)(1) underwriter analysis, because it *is* the issuer for purposes of this exemption. Just as it does not matter how long an issuer “holds” its own securities before distributing them to the public, it does not matter how long an *affiliate* of the issuer does so, because when shares are held by an affiliate, they have not come to rest. Section 4(a)(1) does not exempt sales by an issuer or its control persons. To the extent Respondents argue, in the alternative, that IBEX is not an *underwriter* under Section 4(a)(1) because BIEL’s securities “came to rest” with IBEX, this argument also fails, for the reasons articulated above and in the Division’s Initial Brief.<sup>77</sup>

In sum, Respondents’ contention that “imperfect compliance” does not void the Section 4(a)(1) exemption mischaracterizes the law and conflates Section 5’s different exemptions and safe harbors and their requirements. It is well-established that *attempted* compliance does not show entitlement to exemption, nor does it vitiate liability under Section 5, which is a strict liability statute. There is no case that supports Respondents’ position.<sup>78</sup> As affiliates of the

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<sup>75</sup> Resp. Br. at 31-34.

<sup>76</sup> Initial Br. at 40-45.

<sup>77</sup> See Argument § I.B, *supra*; Initial Br. at 37-40 & n.182.

<sup>78</sup> See e.g., *SEC v. Olins*, not reported in F. Supp. 2d, 2010 WL 900518 (N.D. Cal. 2010) (“At the outset, defendants contend they are not underwriters because they have satisfied four out of the five requirements necessary to meet Rule 144’s safe harbor. In support thereof,

issuer, neither IBEX nor St. John's can escape liability by pointing to "imperfect" compliance with Rule 144.

**F. Respondents Also Engaged in a Plan or Scheme to Evade Section 5's Registration Requirements**

Respondents insist that "[s]erial compliance of law does not establish a plan to evade that law."<sup>79</sup> This assertion depends on Respondents' erroneous premise that they complied with the law.<sup>80</sup> The Division, of course, agrees that *if* IBEX *had* complied with Rule 144 in dozens of transactions and *if* IBEX had steadfastly complied with Section 4(a)'s exemption requirements and Rule 144's safe harbor, then we would not be here. The Commission approved an action against Respondents precisely because they did *not* do these things. Respondents' argument defies logic.

Respondents' liability stems from the fact that they participated in unregistered sales of BIEL to the public market and have not met their burden to show an applicable exemption. Full stop. Strict liability follows regardless of whether Respondents made *one* illegal distribution or (as is the case) *dozens*.<sup>81</sup> The Division is not arguing for "a limitation not already incorporated

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defendants argue that where a seller has met some but not all of Rule 144's safe harbor requirements, "there is a spectrum of conduct that courts consider" and such seller may be found not to be an underwriter if such seller is "near Rule 144 on the spectrum, but not directly on it." Defendants, have cited no case wherein a court has used such a test, and this Court is aware of none.") (internal citations omitted).

<sup>79</sup> Resp. Br. at 34.

<sup>80</sup> *Id.* ("IBEX's steadfast compliance with applicable safe harbor provisions ... reflects a careful, lawful, and honest effort to comply with the letter of the law.").

<sup>81</sup> It also bears repeating that Respondents' repeated references to the "inadvertence" or "honesty" of their Section 5 violations are of no consequence to a finding of Section 5 liability. *See SEC v. Calvo*, 378 F.3d 1211, 1219 (11th Cir. 2004) (strict liability for offering or sale of unregistered securities regardless of seller's degree of fault and intent); *Robert L. Burns*, Investment Advisers Act of 1940 Release No. 3260 (Aug. 5, 2011), 101 SEC Docket 44807, 44826 n.60 (Commission has "repeatedly held that ignorance of the securities laws is not a defense to liability thereunder"); *see also, e.g., SEC v. Lybrand*, 200 F. Supp. 2d 384, 393

into Rule 144.”<sup>82</sup> Respondents are liable under the *existing* Section 5 regime because they cannot establish the Section 4(a) exemption or compliance with all of the requirements of Rule 144.

It is also clear, however, that Respondents engaged in a multi-year campaign to finance BIEL’s operations through distributions of its securities to the market in unregistered transactions, warranting a finding that Respondents orchestrated a plan to circumvent Section 5’s registration requirements.<sup>83</sup> Respondents evidently believe that the Division’s enforcement action gets in the way of small companies’ access to capital and criticize the Division for enforcing the securities laws.<sup>84</sup> Respondents forget the other half of the public contract—BIEL was free to seek public investment, but it needed to do so with full disclosure for the protection of investors. Respondents can’t have one without the other.

It is not the Division’s burden to show a scheme to evade here. Nonetheless, Respondents’ arguments that they did not engage in an orchestrated plan or scheme and instead were “steadfastly compliant,”<sup>85</sup> ring hollow.

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(S.D.N.Y. 2002) (“Their mental state at the time they acquired the shell corporations’ shares is therefore not dispositive; they may still be considered underwriters if they sold shares ‘for an issuer in connection with’ a public distribution of securities.”).

Likewise, Respondents’ arguments (which this Court already has rejected and as to which there is no evidence) that they relied on counsel’s advice in distributing BIEL securities similarly have no bearing on their liability. *Rodney R. Schoelmann*, Securities Act Release No. 9076 (Oct. 23, 2009), 97 SEC Docket 21726, 21745 (attorney’s opinion of “no consequence” to determination of liability under Section 5, as Section 5 is strict liability provision), *aff’d*, 398 F. App’x 603 (D.C. Cir. 2010) (*per curiam*).

<sup>82</sup> Resp. Br. at 35.

<sup>83</sup> Initial Br. at 52-53.

<sup>84</sup> Resp. Br. at 26.

<sup>85</sup> *Id.* at 36.

### G. The DTC Chill Did Not “Require” Any Sales by IBEX

Finally, Respondents argue that “private sales by IBEX were required by the DTC chill,” and that “[t]here were so many transactions because Andrew Whelan was watching out for his shareholders.”<sup>86</sup> Neither of these arguments makes any sense.

First, the DTC chill did not “require” IBEX to do anything. Indeed, Kelly Whelan could have taken the DTC chill placed on BIEL’s stock and her own broker-dealers’ refusal to accept the stock for sale as a sign that it would be a good time to *stop* distributing BIEL shares to the public.<sup>87</sup> Instead, she devised a work-around through sales of convertible notes to Redwood and others, to ensure that even during the period of the DTC chill, she was still able to help BIEL fund its operations through sales of BIEL securities to the public.<sup>88</sup>

Second, Andrew Whelan was not “watching out for his shareholders” by accepting loans from IBEX in “drips and drabs.”<sup>89</sup> Rather, through IBEX’s loans to BIEL, Mr. Whelan was funding BIEL’s day-to-day operating expenses and paying bills as they came due. This is not “investment” in BIEL’s future, but rather keeping the company a hair’s-breadth away from bankruptcy. Investors very likely would have wanted to know that BIEL was using IBEX as a conduit to distribute securities to the public because it could not afford to pay its bills. Further,

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<sup>86</sup> *Id.*

<sup>87</sup> See generally SEC Office of Investor Education and Advocacy, “Investor Bulletin: DTC Chills and Freezes” Imposes Chills and Freezes on Securities for Various Reasons” (May 2012), available at <https://www.sec.gov/investor/alerts/dtcfreezes.pdf>. As this Investor Bulletin notes, the DTC imposes chills on issuer’s stock for various reasons, three of which particularly resonate here: DTC may impose a chill on a security because (i) “the issuer no longer has a transfer agent to facilitate the transfer of the security”; (ii) “DTC becomes aware or is informed by the issuer, its transfer agent, federal or state regulators, or federal or state law enforcement officials that an issuance of some or all of the issuer’s securities or transfer of those securities is in violation of state or federal law”; and/or (iii) “DTC suspects that all or a portion of its holdings of a security may not be freely transferable as is required for DTC services.” *Id.* at 2.

<sup>88</sup> Initial Br. at 12, 13-15, 19.

<sup>89</sup> *Id.* at 6-8.



the net effect of the dozens of transactions here is that BIEL's shareholder value has plummeted through dilution of its stock and investors have been deprived of the information to which they are entitled in registration statements *dozens* of times. Respondents' own arguments underscore the injury they caused to the public.

## II. RESPONDENTS HAVE FAILED TO REBUT THE DIVISION'S SHOWING THAT BIEL AND ANDREW WHELAN VIOLATED SECTION 13

BIEL and Andrew Whelan's post-hearing arguments concerning the Division's Section 13 claims against them are more remarkable for what they do *not* address, than what they do. Respondents do not discuss, let alone contest, much of the Division's showing that the YesDTC and eMarkets transactions failed the revenue recognition criteria of GAAP. They do not contest the Division's proof that there is no evidence of: (i) orders; (ii) transfer of title and risk of loss; (iii) delivery; (iv) fixed pricing for YesDTC; or (v) collectability for eMarkets.<sup>90</sup> Respondents also concede that the YesDTC and eMarkets transactions were not bill and hold sales, contrary to the Company's statements in its 2009 10-K.<sup>91</sup>

Rather, in their brief, Respondents argue several side points relating to the enforceability of the YesDTC and eMarkets Agreements under Maryland's Commercial Code and the common law. These questions of contract interpretation are irrelevant to the issue before the Court—whether BIEL misstated revenue from the transactions *under GAAP*. But even if these side points could inform this Court's decision, Respondents have incorrectly and unreasonably interpreted the language of the contracts under common law. Respondents also continue to misconstrue the law concerning whether BIEL was required to comply with Section 13 of the Exchange Act. For the reasons stated below and in the Division's Initial Brief, BIEL and

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<sup>90</sup> *Id.* at 55-60.

<sup>91</sup> *Id.* at 60-61.

Andrew Whelan violated Section 13 of the Exchange Act and related rules, and nothing Respondents have argued changes the necessary finding of liability.

**A. Respondents Have Misconstrued the Law Concerning BIEL's Obligations to Comply with Exchange Act Section 13**

Respondents' primary argument as to BIEL's lack of liability under Section 13 is that, as a voluntary filer, the Company's Form 8-A12G registration statement never became effective, and that as a result, BIEL was not obligated to comply with the statute and accompanying rules.<sup>92</sup> This is a legal question, and BIEL is wrong on the law. As the Division outlined in its Initial Brief, until BIEL withdrew the registration of its class of securities in April 2011 by filing a Form 15, the Company had a class of securities registered under Section 12(g) and was required to comply with the reporting, books and records, and internal controls provisions of Section 13.<sup>93</sup>

BIEL makes two unsuccessful arguments—one equitable, and one legal—to support its position. The first is that since the Commission did not inform the Company for years that it was required to file Form 10-Ks and 10-Qs, that somehow the Commission should be estopped from enforcing Section 13 now.<sup>94</sup> That position is both unfounded and unreasonable. It is an issuer's obligation, not the Commission's, to ensure that it knows and complies with the securities laws.

The Commission's website makes that point quite clear:

The Division [of Corporation Finance] does not evaluate the merits of any transaction or determine whether an investment is appropriate for any investor. The Division's review process is not a guarantee that the disclosure is complete and accurate—responsibility for complete and accurate disclosure lies with the

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<sup>92</sup> Resp. Br. at 37-41.

<sup>93</sup> See Initial Br. at 66-68.

<sup>94</sup> Resp. Br. at 37-38.

company and others involved in the preparation of a company's filings.<sup>95</sup>

Accordingly, BIEL cannot take advantage of any action or inaction by the Commission to shield its own liability. *See* Exchange Act Section 26 (“No action or failure to act by the [Commission] shall be construed to mean that the [Commission] has in any way passed upon the merits, or given approval to, any security or any transaction....”).

BIEL's second untenable argument, unsupported by any authority, is that its Form 8-A registration statement never became effective because the automatic registration provision in Exchange Act Section 12(g) only applies to mandatory filers.<sup>96</sup> This is an incorrect interpretation of the statute, and one with which both the Commission staff and the Commission itself have explicitly disagreed. As set forth in the Division's Initial Brief and in multiple letters that the Division of Corporation Finance sent to BIEL in 2010,<sup>97</sup> the Form 8-A filed by BIEL automatically became effective 60 days after filing in 2006, *regardless* of whether BIEL was a voluntary or a mandatory filer.<sup>98</sup> The statute, Form 8-A, and Commission comments and guidance do not draw any distinction between whether a registrant is a voluntary or mandatory filer. To the contrary, the Commission emphasized in the adopting release to Securities Act Rule 155:

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<sup>95</sup> Division of Corporation Finance, “Filing Review Process,” (last modified Oct. 12, 2015), *available at* <https://www.sec.gov/corpfin/Article/filing-review-process---corp-fin.html>.

<sup>96</sup> Resp. Br. at 39. Neither BIEL nor Andrew Whelan raised estoppel as an affirmative defense in their Answers to the OIP. *See* Answer and Affirmative Defenses of BioElectronics Corporation (Feb. 29, 2016); Answer and Affirmative Defenses of Andrew Whelan (Feb. 29, 2016).

<sup>97</sup> *See* Correspondence By and Between BIEL and the SEC Div. of Corp. Fin. [DX 83] at 65, 114, 123, 208 (“Corp. Fin. Correspondence”).

<sup>98</sup> *See* Initial Br. at 66-67 (quoting Exchange Act Compliance and Disclosure Interpretations (C&DI) Question 116.06).

If the Form 8-A is filed to register the class of securities under Section 12(g), that section provides that registration will become effective automatically 60 days after filing with the Commission.<sup>99</sup>

The Division of Corporation Finance cited this exact Commission statement in its June 22, 2010 letter to BIEL.<sup>100</sup>

Treating voluntary and mandatory filers consistently is in accord with other Commission staff guidance stating that Section 13 compliance is required whether an issuer was a voluntary registrant or mandatory registrant under Section 12(g):

**Question:** A company that is not required to register a class of equity securities under Section 12(b) or Section 12(g) nevertheless voluntarily registers the class under Section 12(g). Since the registration of the securities under Section 12(g) is voluntary, can the company later stop filing periodic and current reports without first deregistering the securities under the Exchange Act?

**Answer:** No. Once a company registers a class of equity securities under Section 12(g), it is required to file periodic and current reports, even if the registration of the securities under Section 12(g) is voluntary. The only method provided by the Exchange Act and rules for such a company to properly cease

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<sup>99</sup> SEC Release No. 33-7943, available at <https://www.sec.gov/rules/final/33-7943.htm>. This adopting release is entitled to *Chevron* deference as part of the agency's rule-making function. See note 70; *supra*.

Exchange Act C&DI Question 116.04 mirrors the adopting release:

**Question:** Can a company that files a Section 12(g) registration statement on Form 10, Form 20-F, or Form 8-A delay the effectiveness of the registration statement to a date after the 60-day period specified in Section 12(g)?

**Answer:** No. A registration statement on Form 10, Form 20-F, or Form 8-A to register a class of equity securities under Section 12(g) becomes automatically effective 60 days after the date of filing. A company cannot seek to delay the automatic effectiveness of such registration statement. The only way to delay or prevent effectiveness is to withdraw the Section 12(g) registration statement before the effective date.

<sup>100</sup> Corp. Fin. Correspondence [DX 83] at 208.

filing periodic and current reports is to deregister the class of securities under the Exchange Act.<sup>101</sup>

In sum, by voluntarily choosing to become a public reporting company in 2006, BIEL was required to comply with Section 13, from the effective date in April 2006 until the Company withdrew the registration of its class of securities in April 2011. BIEL did not have *carte blanche*, as it argues, to file whatever it wanted, whenever it wanted, and to ignore Section 13's reporting, books and records, and internal controls requirements. Congress and the Commission did not insert into Section 12(g) the regulatory loophole championed by BIEL.

**B. Respondents Concede that BIEL Falsely Reported the eMarkets and YesDTC Transactions as Bill and Hold Sales**

Respondents have no response to three critical facts concerning the eMarkets and YesDTC transactions:

1. BIEL recorded the YesDTC and eMarkets transactions as "*bill and hold sales*" in the 2009 10-K.
2. The transactions were *not* bill and hold sales.
3. BIEL falsely classified the transactions as "*bill and hold sales*" in the 2009 10-K.<sup>102</sup>

The 2009 10-K was thus false as a matter of law and uncontested fact. These misstatements were material, as set forth in the Division's Initial Brief and further below. Nor were these merely "timing" issues, as BIEL incorrectly claims.<sup>103</sup> The transactions were *never* properly classified as bill and hold sales (or traditional sales) and *never* should have been recorded.

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<sup>101</sup> Exchange Act C&DI Question 116.02.

<sup>102</sup> 2009 10-K [DX 51] at 20-21; Initial Brief at 32-33 (citing, *inter alia*, Tr. 363:7-15 (A. Whelan); Tr. 1315:17-16:6 (Linsley) ("Q But you also agree that they were incorrectly recorded as bill and hold transactions. A Yes.")).

<sup>103</sup> Resp. Br. at 54.

**C. Respondents Have Not Introduced Contemporaneous Evidence of Transfer of Title or Risk of Loss**

Although well-aware of the GAAP requirements for documenting transactions, Respondents have failed to identify a single purchase order or sales or shipping document, exchanged in the ordinary course of business, demonstrating that either eMarkets or YesDTC agreed to take title to, or assume the risk of loss on, \$366,000 worth of products.<sup>104</sup> The only documents that Respondents (and Dr. Linsley) identify to establish transfer of title are emails that Mary Whelan and Joseph Noel sent to BIEL's accounting consultant, Esther Ko, in March 2010 in connection with the company's audit.<sup>105</sup> But as Mr. Vondra opined, these after-the-fact emails do not satisfy the documentation requirements of GAAP.<sup>106</sup>

As an initial matter, Mary Whelan does not even assert in her email to Ms. Ko that she assumed title. She left that critical question unanswered.<sup>107</sup> More importantly, these after-the-fact emails, sent by closely-associated parties, in connection with the company's audit, do not represent standard business documentation demanded by GAAP.<sup>108</sup> To the contrary, they suggest that *after* BIEL had booked the transactions, management may have influenced the buyers into representing facts to which the parties had not originally agreed, or even discussed, at the time of contract execution.<sup>109</sup> These representations must be viewed with professional

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<sup>104</sup> See Initial Br. at 26-27, 31; *see also* Tr. 1327:25-1328:9, 1340:3-10 (Linsley).

<sup>105</sup> See Resp. Br. at 44-45 (citing RX 169D); *id.* at 52-54 (citing RX 170C).

<sup>106</sup> See Vondra Report [DX 135] ¶¶ 72-75, 105-108, 123(4); Vondra Supp. Rep. [DX 9] ¶ 1.

<sup>107</sup> See Emails Between Mary Whelan and Esther Ko [RX 170C].

<sup>108</sup> See Initial Br. at 24-25, 56-57.

<sup>109</sup> See Vondra Report [DX 135] ¶¶ 72-75, 105-108, 123(4); Vondra Supp. Rep. [DX 9] ¶ 1.

skepticism,<sup>110</sup> a fundamental accounting and auditing tenet (ignored by Dr. Linsley, who accepted them at “face value”).<sup>111</sup> In any event, whether these emails from Mary Whelan and Joseph Noel raise red flags for earnings manipulation, or are merely untimely and insufficient, they certainly do not satisfy the documentation requirements of GAAP. Respondents have thus failed to satisfy the *persuasive evidence* and *delivery* elements of GAAP for both transactions.<sup>112</sup>

**D. The “Gap Filler” Provisions of the UCC are Irrelevant**

To defend the transactions, Respondents do not attempt to rebut the Division’s showing that (i) GAAP, (ii) BIEL’s standard policies, and (iii) the eMarkets and YesDTC Agreements all required that the parties exchange standard sales documentation.<sup>113</sup> Nor do they identify any GAAP provisions or accounting guidance to support their arguments that the documents exchange by the parties was sufficient.

Instead, Respondents point to certain provisions of the Maryland Commercial Code, modeled after the Uniform Commercial Code (UCC), to argue that the parties had binding agreements.<sup>114</sup> Respondents do not explain, however, how or why these UCC provisions are relevant in this case, when they have no bearing. The relevant issue in this case is whether sales revenue was recordable *under GAAP*—not whether the applicable contracts were enforceable under state law or the UCC.<sup>115</sup> The two issues are distinct. There are many types of agreements—including oral and “handshake” agreements—that a court, to avoid a windfall or default, may enforce under the statute of frauds, or other common law principles, that do not comply with the

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<sup>110</sup> See Vondra Report [DX 135] ¶ 107.

<sup>111</sup> Tr. 1311:18-1312:3 (Linsley).

<sup>112</sup> See Initial Br. at 56-59.

<sup>113</sup> See *id.* at 24-25, 56-57.

<sup>114</sup> Resp. Br. at 45-48.

<sup>115</sup> See Vondra Report [DX 135] at ¶¶ 51, 89.

rigorous documentation requirements of GAAP. In addition, the parties *explicitly* set forth in the contracts what types of documentation must be exchanged;<sup>116</sup> thus, there is no need for this Court to look to the UCC to fill in gaps.

In any event, BIEL's reliance on the UCC is both revealing and troubling. The Company has not come to terms with the fact that as a public reporting company, it was obligated to report its revenue consistently and accurately *under GAAP*, not the common law or UCC. Oral agreements and handshake agreements, incomplete and shoddy paperwork, comingled and offsetting orders, deficiencies in internal controls, and complicated overlapping financial and business dealings among closely-related parties may work for a small, private, family-run business, but not for a public company opting into the public markets. Investors are entitled to receive, and rely upon, accurate financial statements prepared in accordance with GAAP.

**E. Respondents' Interpretation of the YesDTC Contingency is Unreasonable and Unsupported by GAAP**

Respondents' arguments concerning the contingency in the YesDTC Agreement also fail.<sup>117</sup> They cannot rewrite the plain language of the YesDTC Agreement, which gives YesDTC the right, at its sole discretion, to void the contract if it cannot obtain Japanese regulatory clearance in six months. The agreement states, "This agreement is *voidable at the option of Distributor.*"<sup>118</sup>

There is no other reasonable way to interpret this language other than that YesDTC could cancel the agreement, and receive a full refund, if it was unable to obtain Japanese regulatory approval within six months. Respondents overlook the fact that BIEL *could not deliver* the

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<sup>116</sup> See eMarkets Agreement [DX 18] at ¶¶ 4.1, 4.2; YesDTC Agreement [DX 67] at ¶ 6; see also Vondra Supp. Rep. [DX 9] at ¶¶ 3, 4.

<sup>117</sup> See Resp. Br. at 47-48.

<sup>118</sup> YesDTC Agreement [DX 67] at 1.



products to YesDTC unless, and until, the regulatory contingency was satisfied.<sup>119</sup> The provision thus undoubtedly represented a condition precedent to performance—a condition that must have been satisfied *before* the parties could perform.<sup>120</sup> On the other hand, BIEL’s (and Dr. Linsley’s) reading of the contingency as a condition *subsequent* is unreasonable.<sup>121</sup> If YesDTC opted to void the contract after six months, and BIEL refused to refund its payments—even though delivery and performance were impossible—YesDTC clearly would be entitled to demand a full refund, at law or in equity. Otherwise, BIEL would be receiving unjust enrichment and a windfall, by keeping the money and the products.

In any event, the issues that BIEL raises under state contract law are irrelevant. Even if Respondents are right, and Mr. Noel’s rights of acceptance and cancellation were ambiguous or uncertain, SAB 104 explicitly deals with such uncertainty—the seller cannot record revenue for the sale until the uncertainty is resolved and the contingency lapses:

After delivery of a product or performance of a service, if uncertainty exists about customer acceptance, revenue should not be recognized until acceptance occurs... The staff presumes that such contractual customer acceptance provisions are substantive, bargained-for terms of an arrangement. Accordingly, when such contractual customer acceptance provisions exist, the staff generally believes that the seller should not recognize revenue until customer acceptance occurs or the acceptance provisions lapse.<sup>122</sup>

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<sup>119</sup> See Initial Br. at 30, 58.

<sup>120</sup> See *All State Home Mortg., Inc. v. Daniel*, 187 Md. App. 166, 182, 977 A.2d 438, 447 (2009) (“A condition precedent in a contract is a fact, other than mere lapse of time, which, unless excused, must exist or occur before a duty of immediate performance of a promise arises. Where a contractual duty is subject to a condition precedent, whether express or implied, there is no duty of performance and there can be no breach by non-performance until the condition precedent is either performed or excused.”) (internal quotations and citations removed).

<sup>121</sup> See Resp. Br. at 48.

<sup>122</sup> SAB 104 at 23-24.

Finally, even BIEL cannot reasonably dispute that the contingency in the contract rendered the payment owed by YesDTC “subject to refund or adjustment,” as set forth in SAB 104.<sup>123</sup> Neither Respondents in their post-hearing brief, nor Dr. Linsley in his report, addressed this failed fixed pricing element of GAAP, and the Division’s and Mr. Vondra’s position on this element remains uncontested.

**F. Respondents Have Not Rebutted the Division’s Showing that the Transactions Were Material**

The Division’s and Mr. Vondra’s positions as to materiality, for the most part, also remain unchallenged.<sup>124</sup> Respondents only point to two factors to establish lack of materiality: (i) that BIEL’s financial condition was poor, so no reasonable investor would care about \$366,000 worth of misstated revenue; and (ii) lack of stock movement, as presented by their expert, Robert Hills. The Court has already rejected the first argument.<sup>125</sup>

As for the second argument, it, too, is unsuccessful. There is no need to establish stock movement to prove materiality. *See SEC v. Mudd*, 885 F. Supp. 2d 654, 667 (S.D.N.Y. 2012). And even if there were, Mr. Hills’ event study was not the correct tool to attempt to prove lack of materiality. As the Division’s expert, Benjamin Sacks testified: (1) there was never a legitimate curative disclosure of the misinformation here, so an event study is not an appropriate vehicle for testing materiality of the disclosures; (2) Mr. Hills erroneously assumes that if a stock price movement is not statistically significant then an event is not material; and (3) when Mr. Sacks

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<sup>123</sup> See Initial Br. at 59; Vondra Report [DX 135] at ¶¶ 56-59.

<sup>124</sup> Initial Br. at 63-66.

<sup>125</sup> See Summ. Disp. Order at 8-9.

adjusted Mr. Hills' methodology to use the appropriate event window and date, he noted a spike in BIEL's stock price of nearly 10%—clearly consistent with materiality.<sup>126</sup>

### **III. THE SANCTIONS SOUGHT BY THE DIVISION ARE APPROPRIATE AND IN THE PUBLIC INTEREST**

The sanctions sought by the Division are appropriate and in the public interest.<sup>127</sup>

Respondents' arguments to the contrary: (i) ignore the evidence—including evidence of Andrew and Kelly Whelan's willfulness, scienter, and lack of remorse; (ii) hinge on a good-faith reliance on accountants and counsel defense that this Court already has rejected and as to which there is little or no evidence; and (iii) improperly suggest that this Court should take into consideration the alleged inability to pay of BIEL, IBEX, and St. John's, as to which Respondents have adduced little proof.<sup>128</sup> This Court should reject Respondents' arguments and impose the sanctions sought by the Division, which are tailored to redress the public harm caused by Respondents' violations of Sections 5 and 13.

#### **A. Permanent Cease-and-Desist Orders are Warranted**

The egregiousness of Respondents' conduct,<sup>129</sup> the likelihood of continued misconduct, and the harm to the public—as well as all of the *Steadman* factors discussed in the Division's Initial Brief—demonstrate that cease-and-desist orders are necessary to prevent Respondents'

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<sup>126</sup> See Expert Report of Benjamin A. Sacks (Aug. 26, 2016) [DX 136]; Rebuttal Expert Report of Benjamin A. Sacks (Sept. 14, 2016) [DX 8].

<sup>127</sup> Initial Br. at 73-79.

<sup>128</sup> Resp. Br. at 56. Respondents have submitted under seal certain information relating to their current financial condition. Andrew Whelan's wife, Patty Whelan, who is also St. John's principal, has not. Further, inability to pay is only one factor the Court may, as a matter of discretion, consider is assessing monetary penalties. See 17 C.F.R. § 630.

<sup>129</sup> See, e.g., *Charles F. Kirby*, Securities Act Release No. 8174 (Jan. 9, 2013), 79 SEC Docket 1081, 1105 (actions facilitating distribution of unregistered securities worth over a million dollars into the market were egregious), *pet. denied sub nom. Geiger v. SEC*, 363 F.3d 481 (D.C. Cir. 2004); *Douglas W. Osborne*, Initial Decision Release No. 114 (Aug. 18, 1997), 65 SEC Docket 603, 611 (offering and sale of unregistered securities over two years was egregious).

future violations of Sections 5 and 13. *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981); *KPMG Peat Marwick LLP*, 54 S.E.C. 1135, 1191 (2001), *recon. denied*, 55 S.E.C. 1, *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002).<sup>130</sup>

Significantly, Respondents have not acknowledged that that their conduct was improper. Rather, both Andrew and Kelly Whelan continue to maintain that they have done nothing wrong and are apparently puzzled as to why the Commission brought this action at all.<sup>131</sup> Respondents also have not provided any assurances to this Court that they will not violate Section 5 in the future. Indeed, Respondents have indicated their intent to remain in the same businesses and have asked this Court not to “cutoff the life’s blood of BioElectronics’ funding,”<sup>132</sup> which, to date, has consisted of illegal distributions of BIEL’s stock. And, despite overwhelming evidence to the contrary, Andrew Whelan continues to insist that revenue relating to the YesDTC and eMarkets transactions was properly recognized in BIEL’s 2009 10-K.

With respect to their Section 13 violations, Respondents Andrew Whelan and BIEL argue that “there is no rational justification for enjoining further violations of Section 13, since Section 13 has not applied to BioElectronics in more than four years, if ever.”<sup>133</sup> This argument, while perhaps facially appealing, must fail, because Andrew Whelan has not provided any assurance that he will not at some future point seek to register (for example, if a potential lender demanded that BIEL do so). The law is clear that a cease-and-desist order may be entered on proof less than that required for injunctive relief. *KPMG Peat Marwick*, 54 S.E.C. at 1191 (although some

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<sup>130</sup> See also Initial Br. at 74-75.

<sup>131</sup> E.g., Resp. Br. at 59 (“IBEX has suffered more than enough from this action.”).

<sup>132</sup> *Id.* at 60

<sup>133</sup> *Id.* at 57.

likelihood of future violation must be present, the required showing is “significantly less than that required for an injunction”).

**B. The Evidence Supports the Disgorgement and Prejudgment Interest Sought by the Division**

Respondents raise four arguments in opposition to the Division’s request for disgorgement: (i) disgorgement would not be equitable; (ii) there is no proof of a causal connection between the violations and the profits to be disgorged; (iii) any disgorgement award should be limited to transactions in 2013 to 2014 when any asserted scheme to evade the registration requirements was primarily implemented; and (iv) there is no proof distinguishing legitimate and allegedly illegitimate gains.<sup>134</sup> Respondents’ arguments ignore both the evidence and the well-established law with respect to disgorgement for violations of Section 5.

Respondents’ assertion that entry of a disgorgement order against them would be inequitable and “punitive,” because payment would impose hardships on each of the Respondents<sup>135</sup> (especially BioElectronics), is particularly unavailing.<sup>136</sup> It is well-settled that the purpose of disgorgement is to deter violations of the securities laws by depriving defendants of their ill-gotten gains and to prevent the violators’ unjust enrichment. *SEC v. Fishbach Corp.* 133 F.3d 170, 175 (2d Cir. 1997); *First City Fin. Corp., Ltd.*, 890 F.2d 1215, 1231 (D.C. Cir.

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<sup>134</sup> *Id.* at 58.

<sup>135</sup> Respondents argue that a disgorgement order against IBEX would be inappropriate, in part, because “IBEX invested and remains at risk to BIEL for over \$5 million.” Resp. Br. at 59. Respondents provide no citation for this assertion, because there is no evidence in the Record as to IBEX’s current BIEL holdings. If, however, IBEX currently holds 5 million in BIEL notes, a substantial majority of those notes must have issued during the period of the unlawful distribution, making a disgorgement order especially appropriate. Alternatively, if IBEX acquired these shares or notes more recently, it did so during the period of the Division’s investigation and the pendency of this proceeding and thus IBEX’s current holdings indicate that its misconduct has continued and further evidence Kelly Whelan’s lack of remorse.

<sup>136</sup> Resp. Br. at 59.

1989). Thus, disgorgement is appropriate regardless of whether BioElectronics “spent long ago” the proceeds it obtained through IBEX and St. John’s’ unlawful distribution of its securities into the public market and could not now satisfy a large disgorgement order.<sup>137</sup> See *SEC v. Banner Fund Intern*, 211 F.3d 602, 617 (D.C. Cir 2000) (“An order to disgorge establishes a personal liability which the defendant must satisfy regardless whether he retains the selfsame proceeds of his wrongdoing.”).

It is well established that, with respect to Section 5 violations, the total “proceeds obtained from the illegal sale of ... unregistered securities” fairly approximate Respondents’ profits from the illegal conduct. *Platforms Wireless*, 617 F.3d at 1096-97; *SEC v. StratoComm Corp.*, 89 F. Supp. 2d 357, 367-70 (N.D.N.Y. 2015). Once the Division establishes a fair approximation of a disgorgement amount, the burden shifts to Respondents to show that the disgorgement amount is not a reasonable approximation of Respondents’ total gain from the transactions. *SEC v. Video Without Boundaries, Inc.*, No. 08-cv-61517, 2010 WL 5790684, at \*5 (S.D. Fla. Dec. 8, 2010); see also *First City Fin. Corp.*, 890 F.2d at 1232. Respondents fail to carry their burden here.

The Division seeks disgorgement of \$4,246,266, plus prejudgment interest, from Andrew Whelan, BIEL, Kelly Whelan, and IBEX.<sup>138</sup> The Division also seeks disgorgement of

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<sup>137</sup> Respondents argue that “[d]isgorgement against St. John’s would unjustly punish Patricia and Andrew Whelan by denying them the relatively modest proceeds of an investment of cash and salary (██████████ per year) made years before the sales in question.” Resp. Br. at 59. The Division is not seeking disgorgement of Andrew Whelan’s salary for his (or St. John’s) Section 5 violations, and it is unclear why Respondents believe that Andrew Whelan’s salary is the “proceeds obtained” from St. John’s illegal sales of BIEL stock.

<sup>138</sup> Initial Br. at 75-76. Prejudgment interest should be calculated on a transaction-by-transaction basis, from the date of the misconduct to the last day of the month preceding the month in which disgorgement is made, consistent with 17 C.F.R. § 201.600, which makes the payment of prejudgment mandatory on all sums ordered to be disgorged. These dates are set forth in the exhibits to the Joint Stipulation. See Joint Stip. Exs. A & B [DX 1]. Given the

\$397,196.70, plus prejudgment interest, from Andrew Whelan, BIEL, and St. John's.<sup>139</sup> These figures represent a reasonable approximation of Respondents' ill-gotten gains.<sup>140</sup>

Respondents devote a substantial portion of their brief to an argument that they received no actual profits from the unlawful sale of BIEL shares or notes.<sup>141</sup> Respondents make no showing, however, that they provided any independent value when IBEX and St. John's initially obtained the notes and shares from BIEL that should be considered in calculating the profits Respondents realized. In fact, the Record establishes just the opposite. First, it is undisputed that IBEX obtained its notes and shares purportedly in exchange for loans that it funded through earlier sales of BIEL securities into the marketplace. Second, to the extent that St. John's

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volume of BIEL and IBEX's Section 5 violations, the Division suggests that the Court simplify the required calculations, and award prejudgment interest on the \$4,346,266 disgorgement amount from November 17, 2014 (the date of IBEX's last loan to BIEL and its last sale to a Liquidating Entity during the Relevant Period) and the last day of the month preceding the month in which disgorgement is made.

<sup>139</sup> Initial Br. at 75-76. Prejudgment interest on this disgorgement amount should be calculated on each of St. John's 17 sales of BIEL securities between March 26, 2013 and March 6, 2014 and the last day of the month preceding the month in which disgorgement is made, consistent with 17 C.F.R. § 201.600. See Joint Stip. ¶ 35 [DX 1].

<sup>140</sup> Joint and several liability in securities cases is appropriate where, as here "two or more individuals or entities collaborate or have close relationships in engaging in the illegal conduct." *SEC v. Whittemore*, 659 F.3d 1, 9 (D.C. Cir. 2011) (quoting *SEC v. Hughes Capital Corp.*, 124 F.3d 449,455 (3rd Cir. 1997)).

<sup>141</sup> Resp. Br. at 62-66. Respondents' argument that "had IBEX or BioElectronics registered the convertible notes prior to selling them, Redwood Management LLC would not have received any additional information about the investment beyond what was disclosed in BioElectronics' filings with the SEC and the OTC exchange," completely misses the point. *Id.* at 61. The essence of the Congressional Section 5 scheme is to provide bona fide investors with the information required to be furnished in a registration statement. Here, the bona fide investors are those who purchased BIEL securities in the public market, *not* Redwood and the other Liquidating Entities, who were participants in the chain of distribution. Investors who purchased BIEL stock in the market during the Relevant Period were suckered into buying stock in a company that couldn't meet its monthly payroll or pay its operating expenses without distributing its own stock. Moreover, the information provided in a contemporaneous registration statement is not the same thing as an after-the-fact registration statement. Respondents' continued insistence that one is just as good as the other, again underscores their willfulness and scienter.

contends that BioElectronics issued a portion of the shares it sold in lieu of cash for Andrew Whelan's salary, Respondents have offered no evidence relating to what portion of the shares it acquired on this basis and "any risk of uncertainty should fall on the wrongdoer whose illegal conduct created that uncertainty." *SEC v. Patel*, 61 F.3d 137, 140 (2d Cir. 1995); *see also SEC v. Calvo*, 378 F.3d 1211, 1217 (11th Cir. 2004).

Moreover, as to IBEX, Respondents' contention that IBEX did not profit from its illegal conduct is flatly contradicted by Kelly Whelan's own testimony. Ms. Whelan stated that when she sells BIEL convertible notes, she sometimes retains the interest portion of the note, which is how she makes money.<sup>142</sup> Ms. Whelan also insisted that the reason why she makes loans to BIEL, receives in exchange convertible notes, and sells them to parties who then distribute them to the public is because it is profitable to her. Tr. 452:6 (K. Whelan: "I made money doing it."); *id.* at 482:17 (same); *id.* at 512:6-12 (K. Whelan: "Sometimes I do it because, you know, I want to buy a car or take a trip or do some remodeling to my house. Sometimes I've done it because I wanted to make another investment in BioElectronics at a lower stock price than the previous note. It made economic sense for me to do it, so I did it."); *id.* at 1062:2-4 (K. Whelan: testifying that she has used profits to support herself); *see also* Resp. Br. at 33 ("The intent at acquisition was always to become wealthy once BioElectronics obtained FDA approval of its medical device for general retail sale without prescription in the United States."). Although Ms. Whelan was careful not to quantify precisely *how much* money she made during the Relevant Period from her illegal distributions of BIEL stock, her own testimony makes clear that she did profit.

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<sup>142</sup> Tr. 510:19-511:3, 1239:18-25 (K. Whelan).



Respondents' argument that BIEL did not "unjustly profit from its transactions" is similarly illogical.<sup>143</sup> Respondents concede, as they must, that "the money [BIEL] borrowed from IBEX has been spent almost as quickly as it was invested over the years such investments were made."<sup>144</sup> The Record establishes that "the money [BIEL] borrowed from IBEX" was the proceeds of IBEX's sales of BIEL securities to the Liquidating Entities, which in turn sold those securities to the investing public through unregistered transactions.<sup>145</sup> Therefore, because BIEL was using these proceeds to fund its operations, those proceeds represent precisely the amount of BIEL's "profit" from the illegal distributions. As noted above, the fact that BIEL immediately spent its ill-gotten gains does not make them any less ill-gotten and therefore subject to disgorgement.

Respondents apparently also contend that the Court should limit any disgorgement to the profits from transactions that were completed in 2013 to 2014, the period during which the Division's expert testified that, in his view, the Respondents' plan to evade the registration requirements was carried out most intensely.<sup>146</sup> Respondents' suggested limitation on the Division's disgorgement award fails for two primary reasons. First, the evidence shows that there are multiple alternative grounds for finding that Respondents repeatedly violated Section 5 during the Relevant Period, warranting disgorgement even if this Court does not determine that Respondents perpetrated a scheme or plan to evade. Second, although the Division's expert, Mr. Park, testified that Respondents' violations escalated between 2013 and 2014, he concluded that

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<sup>143</sup> Resp. Br. at 65.

<sup>144</sup> *Id.* at 58.

<sup>145</sup> Initial Br. at 3-8.

<sup>146</sup> Resp. Br. at 66.

the plan could be construed to include all transactions during the Relevant Period.<sup>147</sup> Thus, the Court properly may order disgorgement of the proceeds from all the transactions at issue, even if it determines that Respondents' liability turns on their participation in a scheme or plan to evade registration.

### C. The Evidence Supports the Civil Penalties Sought by the Division

Respondents argue that “[a]fter viewing each Respondent giving his or her testimony, the Court undoubtedly came away from the trial believing them to be honest people who may or may not have inadvertently stepped over a yet unwritten rule in the complex securities laws applicable to transactions in unregistered shares. Under these circumstances, no penalty is warranted.”<sup>148</sup> This argument fails on multiple levels.

The Division has detailed the substantial evidence from which this Court can conclude, with respect to their repeated violations of the securities laws, that Respondents are *not* honest and their violations were *not* inadvertent.<sup>149</sup> Thus, while this Court, in appropriate cases, may consider Respondents' state of mind as a factor in mitigation of sanctions, the evidence here establishes that Respondents acted willfully and with scienter.

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<sup>147</sup> Tr. at 137:14 (“Based on my analysis, [the scheme] started in January 2010.”) (Park).

<sup>148</sup> Resp. Br. at 69. The Division also wants to give the Court comfort that the statute of limitations does not defeat the civil penalties it is seeking. The Division and Respondents entered into a series of tolling agreements in this matter for the period of April 17, 2015 through August 17, 2015, extended from August 18, 2015 through October 18, 2015, and again from October 19, 2015 through January 16, 2016, and again from January 20, 2016 through March 25, 2016. These agreements provided that “the running of any statute of limitations applicable to any action or proceeding against Respondents authorized, instituted, or brought by or on behalf of the Commission or to which the Commission is a party arising out of the investigation ... including any sanctions or relief that may be imposed therein, is tolled and suspended for the ... tolling period.” For this reason, Respondents do not even raise the defense, and the Court should not have concerns regarding the age of the conduct at issue.

<sup>149</sup> Initial Br. at 17-21, 76-79; *see also* Argument § I.B, G, *supra*.

The steps that IBEX and BIEL took evidence a sophisticated understanding of Rule 144: (i) BIEL sent letters to transfer agent and purchasers of IBEX shares to reassure them that IBEX was not an affiliate and met technical requirements of Rule 144; (ii) all of the Whelans testified about the lending that went bad because the lender insisted on registration, leading to the inference that they were learning from past mistakes; (iii) Kelly Whelan showed additional adaptive behavior when, in the face of the DTC chill, she figured out another way to achieve Respondents' collective goal to distributed BIEL shares—she found Redwood.<sup>150</sup> In sum, Andrew and Kelly Whelan decided that the legal approach was too expensive and intentionally developed a work-around.

The sheer volume of BIEL securities making their way into the hands of investors in unregistered transactions and the millions of dollars IBEX earned and sent back to BIEL from these transactions also speaks both to Respondents' willfulness and the impact on the investing public.<sup>151</sup> During the Relevant Period, the number of shares of BIEL in the sky-rocketed—from 750 million to 7 billion—all in unregistered transactions. Even if you knock off a zero or two through a hypothetical “reverse split,”<sup>152</sup> the impact on the investing public is inescapable. Respondents' conduct displays a callous disregard for public investors and the federal securities laws.

Although the OIP did not charge Respondents with fraud, the Record is replete with evidence that Respondents deliberately and recklessly disregarded Section 5's requirements, and that their misconduct resulted in “substantial losses or created a significant risk of losses to other persons” (*e.g.*, innocent investors who purchased BIEL's stock in 2009, only to see their share

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<sup>150</sup> See Initial Br. at 12, 13-15, 19.

<sup>151</sup> *Id.* at 17-21, 51-53, 73-79.

<sup>152</sup> Resp. Br. at 35.

value plummet during the Relevant Period as the direct result of Respondents' distributions of BIEL securities in unregistered transactions). The Division also showed that there was "substantial pecuniary gain" to Respondents from their misconduct. During the Relevant Period, Andrew Whelan and BIEL received from IBEX \$4.2MM in loans that were the proceeds of IBEX's distributions of BIEL securities. IBEX and Kelly Whelan went from a struggling company, founded on money taken out of Kelly Whelan's 401K, to a "very liquid" state. The Record also shows that maximum civil penalties are necessary to deter Respondents and are in the interest of justice. 15 U.S.C. § 78u-2(c). Respondents are repeat offenders, having violated Section 5 through *dozens* of transactions and also violated Section 13 and related rules in BIEL's one and only Form 10-K filing.<sup>153</sup>

Under these circumstances, the evidence warrants maximum penalties against, at a minimum, BIEL, IBEX, Andrew Whelan, and Kelly Whelan. Although there is less evidence against St. John's, because St. John's *is* BIEL for purposes of Section 5, Andrew Whelan's reckless disregard of Section 5's requirements and the damage to the investing public caused by his misconduct can likewise be held against St. John's. Maximum penalties should also be imposed against St. John's.

**D. Respondents Have Not Established Inability to Pay**

Under both the Securities Act and the Exchange Act, the Court may consider a respondent's "ability to pay" in assessing whether imposition of a sanction for violating the

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<sup>153</sup> Respondents' reference to "a yet unwritten rule" is puzzling. Registration under Section 5 is the cornerstone of the Securities Act of 1933, a statute with *eight decades* of history. Section 5's prohibition on offering and selling securities in unregistered transactions and Section 4(a)'s exemptions thereto are well-established law. Here, Respondents willfully violated this well-established law, show no understanding of what they did wrong, and have indicated that they may well continue to violate the securities laws going forward.

securities laws is in the public interest. 15 U.S.C. §§ 77h-1(g)(3), 78u-2(d). Although ability to pay is *a factor* for the Court to consider, however, it is not dispositive. *Id.*

Respondents argue that “there is a serious doubt about [BioElectronics’] ability to continue to operate as a going concern, because the company has consistently invested its cash investments and cash flow on its operations and development of its product and cannot survive without new infusions of capital.”<sup>154</sup> In other words, Respondents argue that if this Court puts an end to BIEL’s financing of its operations through distributions of its securities in unregistered transactions, it may well go out of business. But it is past time for BIEL to either prove that it can get legitimate, arms’-length financing, or to file a registration statement and inform investors as to what it is doing. Moreover, the evidence as to the impact a substantial monetary sanction as sought by the Division here would actually have on BIEL is unclear. On the one hand, Respondents maintain that BIEL is not financially dependent on IBEX, has or could attract other lenders, has raised \$33 million over the lifetime of the company, and is “generating over \$2 million annually.”<sup>155</sup> On the other hand, Respondents argue that any payment by BIEL would be punitive and put the Company out of business. Further, even if Respondents were correct that “a substantial award would ... prevent BioElectronics from continuing its business,”<sup>156</sup> the collateral consequences to BIEL’s bona fide investors of a bankruptcy are not the determining factor in evaluating whether sanctions in the public interest. *Nature’s Sunshine Prods., Inc.*, Exchange Act Release No. 59268 (Jan. 21, 2009); 95 SEC Docket 13488, 13500-01; *Gateway Int’l Holdings, Inc.*, Exchange Act Release No. 53907 (May 31, 2006), 88 SEC Docket 430, 438-39,

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<sup>154</sup> Resp. Br. at 74.

<sup>155</sup> Tr. 537:12-18 (M. Whelan); Tr. 857:20-22 (A. Whelan); Tr. 858:12-14 (A. Whelan: “[T]he valuation of this company is a lot more than I think at the—than the 33 million.”); Tr. 888:18-21 (A. Whelan); *see also* Resp. Br. at 60.

<sup>156</sup> Resp. Br. at 74.

441; *Outsource Int'l Inc.*, 55 S.E.C. 382, 393 (2001); *Verdi Dev. Co.*, 38 S.E.C. 553, 557-58 (1958); *Great Sweet Grass Oils, Ltd.*, 37 S.E.C. 683, 698 (1957).<sup>157</sup>

Moreover, although Respondents have submitted some information regarding their individual financial positions, those submissions are incomplete and thus insufficient to warrant a reduction in monetary sanctions otherwise appropriate. For example, although Andrew Whelan's Form D-A suggests that he has limited personal resources, it provides very little information about his wife's assets, despite having acknowledged during his investigative testimony that he deliberately holds very little property in his own name, preferring instead to place most of the couple's joint assets in Patricia Whelan's individual name. Similarly, although Kelly Whelan's individual Form D-A shows limited assets, it fails to include her 100 percent ownership of IBEX. Although IBEX submitted its own Form D-A, Kelly Whelan's failure to include her ownership interest in IBEX on her own form raises the question whether she omitted other entities in which she separately holds substantial assets. Respondents have simply failed to demonstrate an inability to pay monetary sanctions that are appropriate in this case.

### CONCLUSION

For the reasons set forth above and in the Division's Initial Brief, and in light of the Record as a whole, this Court should find all Respondents liable under Section 5 and Andrew Whelan and BIEL liable under Section 13 and related rules and regulations and impose the remedies outlined above and in the Division's Initial Brief.

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<sup>157</sup> The Division also seeks permanent penny stock bars against Andrew and Kelly Whelan for the reasons set forth in its Initial Brief. Initial Brief at 78-79. The Division is not seeking officer and director bars against Andrew and Kelly Whelan, OIP ¶¶ 46-49, and Respondents' arguments at pages 72-73 of their brief are therefore irrelevant.

Dated: November 18, 2016



Charles D. Stodghill (202) 551-4413  
Paul W. Kisslinger (202) 551-4427  
Sarah H. Concannon (202) 551-5361  
Thomas B. Rogers (202) 551-4776  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

COUNSEL FOR THE DIVISION  
OF ENFORCEMENT

## CERTIFICATE OF SERVICE

I hereby certify that true copies of the foregoing were served on the following, this 18<sup>th</sup> day of November 2016, in the manner indicated below:

**By hand and email:**

The Honorable Cameron T. Elliot (*ALJ@sec.gov*)  
Administrative Law Judge  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-2582

**By email:**

Brian T. Corrigan (*bcorrigan@cormorllp.com*)  
Stanley C. Morris (*scm@cormorllp.com*)  
Corrigan & Morris LLP  
201 Santa Monica Blvd., Suite 475  
Santa Monica, CA 90401-2212  
*Counsel to Respondents (other than Mr. Bedwell)*

  
Counsel for the Division of Enforcement