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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of **BIOELECTRONICS CORPORATION, IBEX, LLC, ST. JOHN'S, LLC, ANDREW J. WHELAN, KELLY A. WHELAN, AND ROBERT P. BEDWELL,** Respondents.	Administrative Proceeding File No. 3-17104

RESPONDENTS' REPLY BRIEF IN SUPPORT OF APPEAL TO THE COMMISSION

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I. INTRODUCTION.

Respondents, BioElectronics Corporation ("BIEL"), Ibex, LLC, St. John's, LLC, Andrew Whelan and Kelly Whelan (collectively, "Respondents") submit this Reply Brief to the Division's Opposition. For the reasons stated in the Opening Brief and below, Respondents pray for the elimination or reduction, on a Respondent by Respondent basis, of the proposed sanctions in the Initial Decision issued by ALJ Elliot dated December 13, 2016.

II. ARGUMENTS.

A. The Division's Opposition Overstates And Misstates The Evidence.

The following are just a sample of the many distortions that the Division has employed to try to buttress its weak case.

- Distortion: IBEX controlled BIEL. Div. Opp. p. 19.
- Truth: BIEL had a majority of independent board of directors that was responsible for the control of BIEL. A. Whelan TR 878, 644; R. Staelin 1258-1259; K. Whelan TR 430, 444. Every fact witness at the trial testified that IBEX and Kelly Whelan were not controlled by BIEL and could not control BIEL, including independent board member, Richard Staelin, a Duke University Ph.D, and a professor in the Duke University Fuqua School of Business. R. Staelin 1258-1259. The Commission failed to produce a single witness to testify that IBEX did or could control BIEL or that BIEL did or could control IBEX.
- Distortion: BIEL "falsely record[ed] $366,000 in revenue… [and therefore] issu[ed] a materially false and misleading annual report." Div. Opp. p. 1.
- Truth: BIEL did not falsely report that it received $366,000 in income. That money was received and retained and no refund was ever made. At most, BIEL, whose qualified

auditor approved the reporting, ran afoul of technical bill and hold accounting rules in one single report over isolated transactions, and corrected them in May 2011 once alerted to the problem. Respondents were not charged with any fraud because there was no fraud.

- Distortion: "IBEX, under Kelly Whelan's control, had the ultimate power to bankrupt BIEL when its loans came due, but that it was a 'friendly lender' that chose not to do so." Div. Opp. p. 1; see also p. 20.

- Truth: The IBEX's notes would need to be in default before it could foreclose. There is no evidence of notes in default that were not promptly cured or consensually extended. If not, the loans could have been refinanced by other lenders or paid from the millions of dollars of revenue BIEL generated from product sales. RX 1A-RX 167. IBEX was not BIEL's only lender. DX 1, ¶ 24.

- Distortion: IBEX made millions of dollars in loans to BIEL, while **simultaneously** selling millions of dollars' worth of BIEL Securities to third-party purchasers. (emphasis added). Div. Opp. P. 1.

- Truth: The word "simultaneously" distorts IBEX's conduct. IBEX's conduct was that of a long term private investor in BIEL over 13 years and its conduct was consistent with BIEL's other venture capital investors. The Division's own Opposition at p. 7 concedes that IBEX invested $5 million into BIEL during the Relevant Period, but only sold $4 million to accredited investors (a $1 million net investment it not a distribution or underwriting). IBEX held the securities for an average of 20 months and no less than one year. RX 1A-RX 167. There were no immediate re-sales ever. *Id.* The Division points out that IBEX was very liquid in 2009. How would IBEX have become "very liquid" if it simultaneously sold notes and reinvested the proceeds into BIEL?

- Distortion: "IBEX's sole business has been to finance BioElectronics through sales of BIEL convertible notes and shares to third parties", citing footnote 6. Div. Opp. P. 5.
- Truth: Kelly Whelan actual testimony is included at footnote 6: "IBEX is not anything. It is where I sometimes hold investments" "IBEX doesn't do anything in the securities market. IBEX doesn't do anything." Citing Tr. 1048:13-1049: 15-16; 878:3-16. Ms. Whelan's testimony is not fairly characterized.
- Distortion: "IBEX returned almost all the funds it received from these sales to BIEL." Div. Opp. P. 6.
- Truth: "Returned" implicates that the moneys came from BIEL. They did not. In each of the transactions, sales proceeds were paid by third parties to IBEX or as directed by IBEX. No funds came from or were returned to BIEL.
- Distortion: IBEX sold its notes to third parties "below market price". Div. Opp. P. 7.

  Truth: There was no market for the stock at the time of the DTC Chill and there was no market for the loans sold ever. Moreover, IBEX had no motive to sell its securities below market price.
- Distortion: BIEL "falsely" certified that IBEX was not an affiliate. Div. Opp. P. 7.

  Truth: BIEL was represented by counsel, who advised that IBEX was not an affiliate. At worst, the certifications were innocently mistaken – not intentionally false.
- Distortion: "Kelly Whelan personally became wealthy at the expense of uninformed public shareholders." Div. Opp. P. 9.
- Truth: Kelly Whelan's Form D-A sets forth her financial condition, which is far from anything that could fairly be characterized as wealthy. All of BIEL's transactions with IBEX were fully and fairly disclosed to the public. See RX 171C-S; 194A-C.

- Distortion: "Kelly Whelan never took on any additional investment risk; she simply took the proceeds of sales of BIEL securities and immediately reinvested them in BIEL, …" Div. Opp. P. 10.
- Truth: IBEX (not Kelly Whelan) took on investment risk every time it took its unencumbered money, whether obtained through sales of BIEL securities or not, and invested that money into BIEL, a start-up company whose financial statements included going concern warnings, negative cash flow and no financial commitments. IBEX was under no obligation to invest the proceeds of its sale into BIEL. When it did so, it took on very substantial investment risk with each dollar invested.
- Distortion: Andrew Whelan, Kelly Whelan and BIEL's Board of Directors exhibited no concern for BIEL's public shareholders, whose interests were being diluted every time BIEL authorized additional shares. Div. Opp. P. 10.
- Truth: Whether through debt or equity, a start-up company, such as BIEL, commonly and necessarily finances its operations through debt or equity financing. The dilution is a fact of life fully disclosed to the public shareholders and presumably well understood by them. RX 171C-S; RX 194A-C.
- Distortion: "Ms. Whelan did not acquire BIEL securities with investment intent and *never* intended that the BIEL securities 'rest' with her." Div. Opp. P. 18.
- Truth: IBEX made the investments, not Kelly Whelan. IBEX held its securities for an average of over 20 months, and in many cases over 30 months. See RX 1A.
- Distortion: Kelly Whelan knew that Redwood "was in the business of buying debt, converting it, and selling to the market." Div. Opp. P. 18, 22.
- Truth: Kelly Whelan had no knowledge of Redwood Management's business. She knew her broker would not accept her stock during a DTC Chill. And, Redwood offered to buy

her notes and stock. Tr. 491:6-492:9. That's all she knew. The rest of the testimony and argument constitute speculation by Ms. Whelan and distortion by the Division.

- Distortion: "IBEX round-tripped the majority of the proceeds back to BIEL" Div. Opp. 23.
- Truth: "Round-tripped" cannot be reconciled with the Division's admission that IBEX invested $1 million more into BIEL than it received during the Relevant Period. Div. Opp. p. 7. IBEX was a long-term investor in BIEL. Equally inconsistent is the Division's contention that IBEX was "very liquid." Div. Opp. p. 36-37. One cannot become "very liquid" by round-tripping its sales proceeds.
- Distortion: "St. John's [was] in a position to sell large quantities of unregistered BIEL stock." Div. Opp. P. 26. Truth: St. John's never attempted or intended to sell large quantities of unregistered BIEL stock, but could have done so lawfully under Rule 144 had it chosen to do so. St. John's held the few securities it did sell for at least 34 months. DX 1, ¶¶ 32-35. St. John's converted less than $157,000 of its $2.9 million in debt – only 5.4%! It then sold all but 10 million of the conversion shares over 11 months in 2013 and 2014. It did not sell any other securities during the five years studied. It could have sold many times that amount by filing Form 144s and selling within the volume limits of that rule.

B. ALJ Elliot's Appointment Violated The Appointments Clause of United States Constitution.

On March 30, 2017, the day *after* the Opening Brief was served, the Commission published *Bennett Group Financial Services, LLC*, Release No. 4676, stating its disagreement with the 10th Circuit's decision in *Bandimere v. SEC*, 844 F.3d 1168 (10th Cir. 2016). Since then, on May 3, 2017, the Tenth Circuit denied the Commission's petition for rehearing en banc.

Bandimere v. SEC, 2017 US App. LEXIS 8094 (10th Cir. May 3, 2017). For appellate purposes (and to give the Commission a fair opportunity to alter its position at the time of its ruling on this matter), for the reasons stated in *Bandimere v. SEC* and in their Opening Brief, Respondents seek to vacate the decisions made by ALJ Elliot because ALJ Elliot's appointment violated the Appointments Clause of the United States Constitution. Article 2, section 2, U.S. Constitution.

C. The Disgorgement Relief Proposed Is A Remedy At Law That Cannot Be Awarded In An Administrative Proceeding.

ALJ Elliot had no authority to award the relief of restitution at law, notwithstanding its label as "disgorgement." 15 USCS § 78u-2(d)(5): "the Commission may seek ...equitable relief...." But, it cannot obtain restitution at law by characterizing it as equitable disgorgement. See *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 213-214 (2002); and Ryan, *The Equity Façade of SEC Disgorgement*, Harvard Business Law Review Online (2013) (attached hereto for the convenience of the Commission).

> First, whenever disgorgement is legal rather than equitable, the SEC has no lawful power to seek it in federal court proceedings, and the courts have no lawful power to award it. Being purely a creature of statute, the SEC can lawfully seek in court only those remedies Congress has authorized it to seek, and disgorgement at law is not among those remedies. [Footnote 67: See, e.g., *Am. Bus Ass'n v. Slater*, 231 F.3d 1, 8 (D.C. Cir. 2000) (Sentelle, J., concurring) ("Congress's failure to grant an agency a given power is not an ambiguity as to whether that power has, in fact, been granted. On the contrary, and as this Court persistently has recognized, a statutory silence on the granting of a power is a denial of that power to the agency.").] ... As discussed above, ever since disgorgement was first accepted as a lawful remedy in SEC enforcement, the only plausible sources of authority cited to support it are either the

> courts' inherent power to grant equitable remedies ancillary to their explicit statutory power to grant injunctive relief [Footnote 69 omitted] or the recent statutory provision for "equitable relief" added by Sarbanes-Oxley. [Footnote 70 omitted.] If and when disgorgement is not in fact an equitable remedy, neither source of lawful authority is available.

Id. at p. 12.

Here, although labeled as disgorgement, the disgorgement awards would be at law for restitution because the funds ordered disgorged are not in the possession of those ordered to disgorge such funds. See *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 209-214 (2002). The Supreme Court explains the difference between equitable relief and relief at law as follows:

> In cases in which the plaintiff "could not assert title or right to possession of particular property, but in which nevertheless he might be able to show just grounds for recovering money to pay for some benefit the defendant had received from him," the plaintiff had a right to restitution at law through an action derived from the common law writ of assumpsit. 1 Dobbs § 4.2(1), at 571. See also *Muir, supra*, at 37. **In such cases, the plaintiff's claim was considered legal because he sought "to obtain a judgment imposing a merely personal liability upon the defendant to pay a sum of money."** Restatement of Restitution § 160, Comment a, pp. 641-642 (1936). **Such claims were viewed essentially as actions at law for breach of contract** (whether the contract was actual or implied). **In contrast, a plaintiff could seek restitution in equity, ordinarily in the form of a constructive trust or an equitable lien, where money or property identified as belonging in good conscience to the plaintiff could clearly be traced to particular funds or property**

in the defendant's possession. See 1 Dobbs § 4.3(1), at 587-588; Restatement of Restitution, supra, § 160, Comment a, at 641-642; 1 G. Palmer, Law of Restitution § 1.4, p. 17; § 3.7, p. 262 (1978). A court of equity could then order a defendant to transfer title (in the case of the constructive trust) or to give a security interest (in the case of the equitable lien) to a plaintiff who was, in the eyes of equity, the true owner. **But where "the property [sought to be recovered] or its proceeds have been dissipated so that no product remains, [the plaintiff's] claim is only that of a general creditor," and the plaintiff "cannot enforce a constructive trust of or an equitable lien upon other property of the [defendant]." Restatement of Restitution, supra, § 215, Comment a, at 867. Thus, for restitution to lie in equity, the action generally must seek not to impose personal liability on the defendant, but to restore to the plaintiff particular funds or property in the defendant's possession.** [Footnote omitted.]

Here, the funds to which petitioners claim an entitlement under the Plan's reimbursement provision -- the proceeds from the settlement of respondents' tort action -- **are not in respondents' possession**. ... **The basis for petitioners' claim is not that respondents hold particular funds that, in good conscience, belong to petitioners, but that petitioners are contractually entitled to some funds for benefits that they conferred**. **The kind of restitution that petitioners seek, therefore, is not equitable -- the imposition of a constructive trust or equitable lien on particular property -- but legal -- the imposition of personal liability for the benefits that they conferred upon respondents.**

Emphasis added. Id. at pp. 209-214.

Here, the Respondents no longer have the funds proposed to be disgorged. Accordingly, the relief proposed by ALJ Elliot is an award of restitution at law, not an award of disgorgement in equity. The proposed award is not only at law, but also punitive. The statute authorizing such award mandates that it be levied only if a penalty is owed. See 15 USCS §78u-2(e) ("**In any proceeding in which** the Commission or the appropriate regulatory agency **may impose a penalty under this section**, the Commission or the appropriate regulatory agency may enter an order requiring accounting and disgorgement, including reasonable interest." Emphasis added.) The award would be joint and several liability against several defendants, only one of which received any of the profits to be disgorged, and none of which retained the funds. It is plainly and substantively restitution at law.

IBEX holds no ill-gotten gains because it invested more than it received during the relevant period. It holds only unmarketable notes in BIEL. The proposed award is not to disgorge those unmarketable notes, but instead to disgorge the money IBEX long ago invested in BIEL and no longer retains.

Similarly, the award against BIEL and St. John's is not tied to funds in hand. St. John's invested in BIEL. BIEL spent the proceeds of the relevant transactions years ago. See RX 171C-S; and RX 194A-C.

Even more obviously, disgorgement should not apply to Andrew Whelan or Kelly Whelan who, individually, never received nor retained the proceeds to be disgorged.

In sum, no such funds remain in the hands of Respondents. See Form D-A Disclosures filed with the Opening Brief. Thus, the relief proposed is not equitable disgorgement – but an award at law for restitution of moneys previously received and thereafter spent.

ALJ Elliot and this Commission have no statutory or other authority to award such relief at law premised on an administrative proceeding conducted without the right to a jury trial. *See Granfinanciera S.A. v. Nordberg ("Granfinanciera")*, 492 U.S. 33, 44-50 (1989).

D. Most Of The Award Is Barred By A 5-Year Statute of Limitations - 28 USC §2462.

The five-year statute of limitations (28 USC §2462) applicable to penalties should be applied to the restitution award. 28 U.S.C. § 2462; *SEC v. Graham*, 823 F.3d 1357 (11th Cir. Fla. 2016). The statutory basis for a disgorgement award requires that a penalty. 15 USCS §78u-2(e). Because most sales by IBEX generated no profits, and the few profitable trades were very heavily weighted toward the beginning of such five-year period, a very substantial reduction of the proposed award is required, as explained in the Opening Brief.

*In re Larry P. Grossma*n, Release No. 10227 (pp. 20-21), 2016 WL 5571616, at * 16 (Sept. 30, 2016), on which the Division relies, was published before the Supreme Court granted certiorari, on January 13, 2017, in *Kokesh v. Securities and Exchange Commission* (U.S. Jan. 13, 2017) (No. 16-529). At oral argument on April 18, 2017, the Supreme Court Justices appeared inclined to apply the five-year statute of limitations to the SEC's disgorgement claims. See, for example, *Kokesh v. Securities and Exchange Commission: A New Limitation to the Government's Enforcement Power?* Securities Law Perspectives, posted April 21, 2017 at Securitieslawperspectives.com.; and *Callahan, et al., Supreme Court to Decide Limitations Period for Securities and Exchange Commission Enforcement Matters,* posted by Arnold & Porter Kaye Scholer at www.apks.com April 20, 2017.

Moreover, the *Grossman* decision did not analyze whether the award was equitable disgorgement, or, as here, truly an award of restitution at law.

E. The Penalties Proposed (Including So-Called Disgorgement) Would Be Excessive In Light Of The Culpability Of Each Respondent and Each Respondent's Limited Financial Resources.

The penalties, if any, should be limited by each Respondent's ability to pay. Updated Form D-A's were submitted with the Opening Brief.

Moreover, each Respondent's good faith and limited role warrants consideration. IBEX sold convertible notes and stock privately. It and Kelly Whelan had nothing to do with the removal of the legends on stock, the conversion or the sale of those shares by the buyers or their successors or assigns. Only BIEL controlled those matters. Accordingly, as to most of the transactions upon which ALJ Elliot has proposed an award, IBEX and Kelly Whelan should not be liable.

F. Disgorgement Should Be Limited To Actual Ill-Gotten Gains Received and Retained On A Respondent By Respondent Basis.

Because section 5 is a strict liability offense, the typical measure of disgorgement is all profits made on the sale of unregistered securities, minus the direct transaction costs of acquiring the shares. See, e.g., *SEC v. Universal Exp., Inc.*, 438 Fed App'x 23, 26 (2d Cir. 2011); *SEC v. Cavanagh*, No. 98 Civ. 1818, 2004 WL 1594818, at *30 (S.D.N.Y.Jul. 16, 2004), *aff'd by Cavanagh*, 445 F.3d at 116-17.

"Where an individual or entity has collaborated or worked closely with another individual or entity to violate the securities laws, those individuals and/or entities may be held jointly and severally liable for any disgorgement." *Universal Exp.*, 646 F. Supp. 2d at 563 (citing First Jersey, 101 F.3d at 1475). "In such situations, the joint tortfeasors then bear the burden of demonstrating that their liability can be reasonably apportioned." *SEC v. Credit Bancorp, Ltd.*, No. 99 Civ. 11395, 2011 WL 666158, at 3 (S.D.N.Y. Feb. 14, 2011).

Respondents have met that burden. See DX 1; and RX 1A and 1F; also RX 1-167. In summary, ass to IBEX: "Overall, from January 2010 through February 9, 2015, IBEX received approximately $4 million from the Liquidating Entities and sent approximately $5 million to BIEL." Division's Opposition, p. 7. IBEX ended up with a larger balance in convertible notes, not profits. "IBEX's assets, although substantial on paper, are comprised almost entirely of BIEL notes, which BIEL cannot repay and which are likely so illiquid as to be unmarketable." Initial Decision, p. 57. There is no justification, under these circumstances, to charge IBEX with an additional award of several million dollars as ill-gotten gains, because IBEX received no gains.

The Division claims IBEX and Kelly Whelan became wealthy and "very liquid". See Division's Opposition, pp. 9, 26 and 37. The Division understands that is not the case. See IBEX's and Kelly Whelan's Form D-A. IBEX's statement of cash admitted at the hearing (see RX 210) and its Form D-A filed with the Court and Kelly Whelan's testimony from which the Division's quote was taken reveal that IBEX was very liquid **eight years ago** -- in the middle of 2009 -- but now holds nominal cash and over $5 million in unmarketable notes issued by BIEL. It paid $5 million for those notes which likely would be worthless if the relief sought by the Division is awarded against BIEL.

The transactions giving rise to IBEX's "very liquid" state in 2009 were not part of the OIP or More Definitive Statement, were not tested at trial, and should not be considered in any award. Moreover, the Division's theory of "round-tripping" is patently inconsistent with IBEX being very liquid in 2009. IBEX could not have generated $3.8 million in sales proceed with "simultaneous" sales and "round-tripping". Thus, the Commission cannot fairly superimpose its understanding of the transactions that were tested from 2013 and 2014 to the transactions that might have generated IBEX's liquidity in the middle of 2009, before the relevant period defined by the More Definitive Statement.

The same argument applies to St. John's, whose nominal sales of just 5.4% of its $2.9 million in promissory notes generated no ill-gotten gains. Paragraphs 31-35 of DX 1 confirms St. John's loaned $2.9 million to BIEL after 2009, and converted only $157,000 of that balance. St. John's sold about $15,000 of the conversion shares in 2009, and the balance (approximately $382,000) between February 25, 2010 and March 6, 2010. All sales were through a registered broker pursuant to a legal opinion letter. DX-1, ¶ 34. Like IBEX, St. John's continued to invest substantially greater sums into BIEL than it received from such sales. St. John's would suffer substantial losses from such investments in BIEL should an award against BIEL be sustained.

The ultimate beneficiary of all loans made to BIEL by IBEX and St. John's was BIEL itself. Each time BIEL borrowed money, it exchanged such loan for debt in the amount of the money borrowed. In each case, because it incurred debt in the same amount that it received in cash, it did not profit from those loans and therefore it received no ill-gotten gains.

Even if BIEL did profit from the loans (which it did not), BIEL retains today no such funds. RX 171C-S, inclusive, and RX 194A-C, inclusive. Any disgorgement awarded would be either a penalty or an illicit award of restitution at law.

The same applies to Andrew Whelan and Kelly Whelan, neither of whom directly participated in any such transactions, and neither of whom received a penny of proceeds, much less gains, ill-gotten or otherwise.

G. ALJ Elliot's Improper Exclusion Of Evidence Taints The Entire Initial Decision.

The Division all but concedes that ALJ Elliot improperly excluded evidence, but claims no harm -- no foul. Unfortunately, no one can accurately assess how much of ALJ Elliot's decision was tainted by his refusal to admit and consider evidence that would have proven helpful to the Respondents. This case was a non-scienter action. Extraordinarily, it devolved into a third-tier penalty proposed award after ALJ Elliot excluded Respondents' character

witness testimony (from Brian Flood and Richard Staelin), as well as expert witnesses on the legal and factual issues pertinent to the case. The Division spent $100,000 on its PWCoopers accounting expert for the sole apparent purpose of attacking A. Whelan's testimony. They cannot now claim that character witness testimony is unimportant to counterbalance such attack. The penny stock bar, for example, reflects a finding that without an injunction, the Respondents could not be trusted not to violate the securities laws in the future. While it is true that favorable testimony might or might not have swayed ALJ Elliot or this Commission, the Respondents were entitled to put on their case, particularly in light of the fact that this Commission might consider the entire matter *de novo*. Excluding that evidence deprived Respondents of due process of law and presumably impacted the outcome of the case.

H. The Section 5 Charges Should Not Succeed As Against IBEX and Kelly Whelan.

The Division makes clear throughout its Opposition Brief that its section 5 charges are based on its contention that each time BIEL issued to St. John's and IBEX a promissory note, it set into motion a distribution of shares into the public market. See Division's Amended Opposition, pp. 2-3, 8, 14-18, 20, 21, 23-25, 31, 36 and 37.[1]

"Distribution" is not defined in the securities statutes. "The Division's position is that holding periods are irrelevant, because IBEX's sales of BIEL securities to third parties were

[1] The Division overstates its expert witness's testimony as to the term of the so-called distribution. The Division references at footnote 115 Mr. Park's initial testimony, before cross-examination, that the distribution scheme started in January 2010. But, on cross-examination, Mr. Park was forced to come clean and back off that testimony because, among other things, there were no transactions of that sort during all of 2012. Mr. Park acknowledged no such transactions in 2012, which he originally testified was a period of intense lending, and instead testified that the purported distribution scheme period he studied was only in 2013 and 2014 and that it is possible that no distribution scheme existed before those years. Compare Division's Opposition, p. 34 with Park Testimony, pp. 137, 155 and 201. Accordingly, any disgorgement should be limited to transactions over that period of 2013 and 2014.

inextricably conjoined with IBEX's round-tripping of the sale proceeds back to BIEL." Div. Opp. p. 24-25.

At the core of the debate is what is relevant to the issue of distribution: the holding period of the security; or whether the proceeds of the sale were round-tripped back into the company?

Round-tripping implies that IBEX bought the note on day 1, sold the note on day 2, and reinvested the note proceeds into BIEL to purchase a new note on day 3. But, the chronology was, instead, the note was purchased on day 1, an average of 20 months passed by, then the note was sold privately on day 600 or so, and, in many cases, the proceeds of the sale were reinvested into BIEL on day 603.

The securities at issue in this case came to rest with IBEX for 20 months on average.

IBEX sold no securities to the public in the relevant period. There was no public market for the convertible notes. Ms. Whelan testified that IBEX sold such stock privately because a DTC Chill was in effect -- there was no public market.

To the extent the third parties, working with BIEL, did so, IBEX was not involved. IBEX did not have or exercise any control over the transactions.

The Division weakly contests the timing of the loans made under the Revolving Loan. But, the testimony of Kelly Whelan on that topic, and the documentation at Exhibit RX 1F – RX 167, among others, together with Brian Flood's testimony, expert report and Exhibit RX 1A, support all such holding periods. RX 1-167, RX 206; TR. 1112 *et seq*., TR. 1202 *et seq*. Moreover, after August 2009, each loan was separately documented, renewed and, if sold, sold separately through individualized sale agreements. See last page of RX 1F.

These lengthy periods of rest – which the Division self-servingly deems "irrelevant" -- is, by definition in Rule 144, the single most important factor.

In stark contrast, what is irrelevant in a Rule 144 analysis, is the central fact on which the Division's analysis is grounded – "round-tripping". "Round-tripping" finds no home in Rule 144. Under Rule 144, if the security is held long enough by a non-insider (now only 6 months), it is deemed to have come to rest in the owner's hands. The owner is then free to sell it, and the proceeds can be used for anything the seller desires. There is nothing that prohibits the same investor from investing the proceeds of legal Rule 144 safe harbor sales transactions in the same issuer. In fact, it is consistent with the purposes of Rule 144 to encourage investment in start-up companies. If the Commission is going to create new limits in the Rule 144 "safe harbor", the Division would successfully convert what is billed as a "safe harbor", into a rocky shoal in a hurricane. Citizens should not be punished for not knowing that the Commission would, after the fact, impose an exception to Rule 144 that would render their previously compliant transactions illegal.

Because IBEX is not an affiliate and complied, in all respects, with Rule 144, it is entitled by the "safe harbor" to be safe from claims that it violated Section 5.

To the extent the Commission finds that IBEX was an affiliate of BIEL, it should when IBEX became an affiliate. The Division conflates events and transactions that took place over many years, without identifying when it proposes that IBEX became an affiliate. Only from that point forward should IBEX's transactions be deemed affiliate transactions.

Even if IBEX became an affiliate at some point (which it did not), the transactions were exempt as private transactions under what is commonly referred to as Section 4(1½). "It is generally accepted that affiliates and holders of restricted securities may make sales outside of Rule 144 in private transactions pursuant to the so-called 'Section 4(1 ½) exemption.'" See Securities Law Techniques, A.A. Sommers. The Commission has acknowledged that Section 4(1½) exemption in a 1980 release stating: "It is a hybrid exemption not specifically provided for

in the 1933 Act but clearly within its intended purpose. The exemption basically would permit affiliates to make private sales of securities held by them so long as some of the established criteria for sales under both Section 4(1) and 4(2) of the Act are satisfied." SEC. Act. Rel. No. 33-6188, 1 Fed. Sec. L. Rep. (CCH ¶ 1051).

A.A. Sommers explains the 4 (1½) exemption: "Whether the seller is an 'underwriter' (the only relevant inquiry assuming the seller is not a 'dealer') turns upon whether the sale involves a 'distribution.' The term 'distribution' is not defined in the 1933 Act but is generally considered synonymous with 'public offering.' In connection with Section 4(2) the Commission has issued substantial guidance in releases and no-action letters directing what constitutes a 'public offering.'" The important factors are widely understood to be (i) buyer access to information; (ii) manner of the offering; and (iii) restrictions on resale.

Here, the buyers of stock and notes, who then sold their stock and notes, were accredited and sophisticated investors. They had access to adequate financial information on the OTC Markets web site and the SEC.gov web site. See RX 171C-S; and RX 194A-C. The buyers solicited the investments from IBEX, not the other way around. The restrictions on the sale were governed by BIEL. Over $2 million of the promissory notes and stock sold by Kelly Whelan and IBEX were to one buyer, Redwood Management LLC. Redwood Management expressly represented itself as an "accredited investor" in the Securities Settlement Agreements (see paragraph 4) and Assumption and Assignment Agreements (see paragraph 7). See RX 80, 96, 120, 136 and 167.

IBEX was not required to place restrictions on resale, because, with respect to the convertible note sales (approximately $2.6 million per Exhibit B of DX 1), there was no public market for such notes. And, with respect to the stock sales to private parties ($1.6 million per Exhibit B of DX 1), a DTC Chill was in effect. The stock sales, testified K. Whelan, were made

privately expressly because IBEX was unable to sell such stock through its broker dealer. See Tr. 491:6-492:9. Thus, IBEX fully complied with Section 4(1 ½) even if it is deemed an affiliate.

The Division makes much of the volume of the shares sold, but fails to disclose the stock was trading at a tiny fraction of a penny. Nonetheless, the volume is entirely irrelevant to the determination of whether there has been a Section 5 violation. *Ralston Purina*, 346 U.S. 119, 124 (1953). The applicability of the § 4(1) exemption turns not on the number of shares involved, but "on whether the particular class of persons affected need the protection of the Act." *Id.* at 125. See also, *Ackerberg v. Johnson*, 892 F.2d 1328, 1337 (8th Cir. 1989); *SEC v. Dolnick*, 501 F.2d 1279, 1282 (7th Cir. 1974); *Quinn & Co. v. SEC*, 452 F.2d 943, 946 (10th Cir. 1971); *Gilligan, Will & Co. v. SEC*, 267 F.2d 461, 467 (2d Cir. 1959).

I. St. John's Sales Satisfies Pre-Rule 144 Standards For Affiliate Sales.

St. John's made a few isolated sales years ago and nearly three years after it became at risk for such loans. DX 1, Exhibits B and B; RX 1A; RX 1-167; TR. 1112 *et seq.*; TR. 1202 *et seq*. St. John's' sales were limited to 5.4% of its notes, and to only 11 months of the 5-year period analyzed. Its only deficiency was its failure to file a Form 144, which was omitted only because its lawyer, Lex Kuhne, told them no such form was required because BIEL had no securities registered with the SEC.

St. John's had no intention to distribute its stock to the public generally. Indeed, it could have liquidated far more stock over such five-year period, perfectly legally, had it simply filed Form 144s and sold within the volume limitations under that rule. Its isolated and limited sales speak louder to its true intention than any hyperbole offered by the Division.

The Division falsely claims, without a shred of evidence, that St. John's funded its loans based on ill-gotten gains from Section 5 violations. Division's Opposition, p. 33. St. John's loans, instead, arose largely from the deferral of salary owed to A. Whelan.

J. Section 13 Violations, if any, Do Not Justify Harsh Disgorgement and Penalties.

BIEL has not owed reporting requirements under Section 13, if ever, since April 18, 2011. Div. Opp. pp. 12-13. BIEL's only deficiency in its reporting before that was cured on May 2011. *Id.* The accounting issue debated is about two isolated transactions and only $366,000, which amount was indisputably received and retained by BIEL, as disclosed to its shareholders. So, why are we talking about that isolated deficiency? The only conceivable reason is because the Division hopes to taint the Commission's view of the Respondents in the hope of achieving an otherwise undeserved disgorgement and punitive award.

The debate over whether Section 13 applies is fully briefed in the Opening Brief. Whether BIEL reported the receipts properly or not is a matter of legitimate debate. But, however, the Commission comes out on it, this historically insignificant issue should not be used, as the Division hopes, to impugn the character of Andrew Whelan, who did nothing more than any other CEO would need to do in such circumstances, follow the advice of his accountants and lawyers about how to properly record and reflect such extraordinary transactions on his publicly released financial statements.

K. Reliance on Counsel Shows Good Faith Efforts To Comply With Applicable Securities Laws.

The advice of counsel testimony is not put on as a defense. It was part of an explanation of the Respondents' good faith in engaging in the transactions at issue and in approving the financial reports as prepared. ALJ Elliot unfairly disregarded and prevented such testimony. Such constitutes prejudicial error.

L. The Commission Should Not Impose a Permanent Penny Stock Bar On First Time Offenders Who Reasonably Relied on Counsel's Advice Based on a Non-Scienter Violation

Permanent or a temporary penny stock bars are appropriate if the misconduct involved fraud, recidivism, or ignored red flags -- that is the not the case here. *See Vladimir Boris Bugarski*, Exchange Act Release No. 66842, 2012 SEC LEXIS 1267, at 18 n.26 (Apr. 20, 2012). Although scienter is not an element of Section 5, it must be considered in connection with the nature and extent of civil remedies imposed. *SEC v. Universal Major Ind. Corp.*, 546 F.2d 1044, 1048 (2d Cir. 1976). A penny stock bar might even be imposed in connection with a non-scienter Section 5 violation if the respondent was an experienced trained attorney, or licensed broker. Here, neither Kelly Whelan nor her father have any experience or training necessary to navigate Sections 4 and 5's byzantine system of regulations and exemptions. There were no red flags to warn them. Indeed, the Whelans, who were familiar with a number of other entities that operated in similar manner, relied on professionals such as BIEL's auditors and attorney Lex Kuhne, Esq., that advised them such conduct was legal. TR. 907-908; DX 33. See, legal opinion letters e.g. RX 39, 41, 43, 45, 69, 71, 74, 76, 78, 80, 81, 82, 85, 87, 88, 89, 91, 94, 98, 101, 103, 105, 108, 110, 113, 114A, 115, 119, 123, 127, 128, 129, 131, 133, 134, 136, 138, 139, 141, 142, 144, 145, 147, 148, 149, 151, 154, 155, 157, 158, 160, 162, 166, 167, 172G, 192. See also RT 417 where K. Whelan testified: "I rely on the opinions of my attorneys."

The Commission regularly takes into account scienter when granting waivers to entities subject to cease and desist orders or injunctions that would make them ineligible under Rule 405 and rule 506(d)(2)(ii) of Regulation D. Goldman Sachs & Co. No Action Ltr. 2016 SEC No-Act. LEXIS 428. Reckless conduct "either known to the defendant or so obvious that the defendant had to have been aware of it" can constitute scienter justifying a permanent penny stock bar.

Kalnit v. Eichler, 264 F.3d 131, 142 (2d Cir. 2001); *SEC v. Elliott*, 2012 U.S. Dist. 17-18 (S.D.N.Y. June 12, 2012); *SEC v. Offill*, 2012 WL 1138622, at 5. But, here, Respondents' attorney approved transactions, which are described in detail in BIEL's SEC and OTC filings. BIEL's independent public accountants never warned Respondents of any issue, and in the case of St. John's, a SEC registered broker sold the securities. Every issuance of unregistered securities at issue in the case was predicated upon a formal legal opinion letter to the transfer agent. ALJ Elliot expressly references the dozens of opinions of counsel (cited above) in the Initial Decision at p. 13. At the hearing, Judge Elliot recognized that legal opinion letters "may negate scienter." RT, p. 25, ln 8.

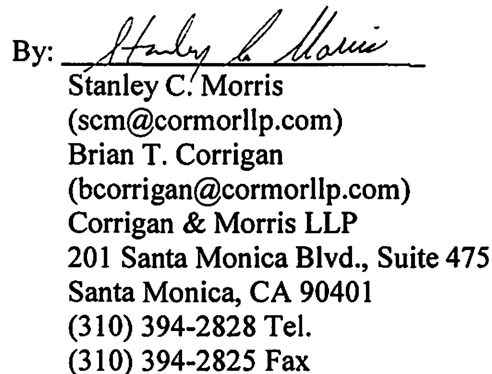
Unfortunately, ALJ Elliot improperly rebuffed Respondents' attempts to show their good faith attempts to comply with Section 5. At one revealing moment, ALJ Elliot announced that "I HAVE NEVER FOUND ADVICE OF COUNSEL." RT 922. Meanwhile, Division Counsel Concannon successfully persuaded him to exclude such evidence, objecting: "...under Section 5, these are non-intent, non-fraud offenses, and I would ask that counsel refrain from seeming to conflate these two issues." RT 920. Under these circumstances, no penny stock bar is warranted.

III. CONCLUSION.

ALJ Elliot was not duly appointed. Even if he was, the award proposed was not an authorized remedy in equity, but constitutes restitution at law outside the Commission's statutory authority. To the extent it was intended as a penalty, the awards exceeded the applicable statute of limitations for penalty awards. An award, if any, must be limited to an award in equity to disgorge ill-gotten gains still retained, on a Respondent by Respondent basis, and any penalties must be limited to the transactions within the five-year statute of limitations. The Section 5 violations are non-scienter violations, if any. The awards should consider the fact that IBEX and St. John's were long term investors who sold BIEL securities after holding them for more than a

year, and on average over 20 months (34 months for St. John's) and who invested much more into BIEL than the BIEL securities sold during the relevant period. The Commission should also levy penalties, if any, only after considering that such transactions were executed by laypersons only after securing advice of counsel. Judge Elliot's exclusion of evidence on the advice of counsel, among others, prevents a full consideration of the facts relevant to such an award. St. John's very limited and isolated sales of only 5.4% of its loans should be viewed against the backdrop that its only deficiency was the failure to timely file a Form 144. Moreover, if St. John's had an intention to distribute its shares, as the Division recklessly contends, it would not have sold 81 million shares for $397,000 over 11 months in 2013 and 2014, but would have legally sold many times that number of shares over the five-year relevant period by simply filing Form 144s and selling the shares within the volume limits prescribed by that rule. For the reasons detailed in the Opening Brief and above, the Commission should eliminate any award or, at most, award the Division only that relief that constitutes ill-gotten profits causally connected to specific Section 5 violations during the 5-year statute of limitations, and only to the extent that such ill-gotten profits can be traced to funds that remain in the hands of each Respondent. No penny stock bar is warranted. It would be in the best interests of shareholders, investors, employees and the public at large that the Commission exercise due restraint in imposing any monetary or injunctive relief in this case.

Dated: May 12, 2017



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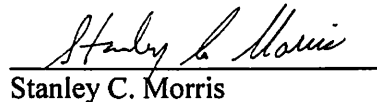
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of **BIOELECTRONICS CORPORATION, IBEX, LLC, ST. JOHN'S, LLC, ANDREW J. WHELAN, KELLY A. WHELAN, AND ROBERT P. BEDWELL,** Respondents.	Administrative Proceeding File No. 3-17104

CERTIFICATE OF COMPLIANCE

I hereby certify that Respondents Reply Brief in Support of Appeal to the Commission complies with the length limitations of SEC Rule of Practice 450(d). I further certify that this brief was prepared using Microsoft Word and that the word count for the document is 6,997 words.

This 12th Day of May 2017.



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CERTIFICATE OF SERVICE

I hereby certify that I served a true and correct copy of the following documents on the date and in the manner indicated below:

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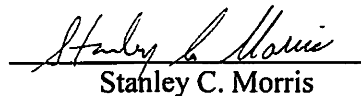

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