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

Administrative Proceeding
File No. 3-17551

In the Matter of

Med-X, Inc.,
Respondent.

DIVISION OF ENFORCEMENT'S PRE-HEARING BRIEF

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I. INTRODUCTION

Section 5 of the Securities Act generally prohibits the sale of a security unless a registration statement is in effect. 15 U.S.C. §77e. The Securities Act provides certain exemptions to the registration requirements of Section 5. This case concerns the efforts of Med-X, Inc. ("Med-X"), a California-based start-up company, to raise capital through Regulation A+, an exemption to Section 5. Med-X failed to fulfill Regulation A+'s requirements designed to ensure that participants in the offering have adequate and timely information regarding their investment. As a result of this failure, the Division of Enforcement ("Division") contends that Med-X is precluded from using this exemption to Section 5's general registration requirement. The Division expects that the facts comprising Med-X's violation of regulation A+ will largely be undisputed at the hearing. The evidence will demonstrate that Med-X failed to file a required annual report and sold stock to numerous investors over a four-month period when it was

prohibited from doing so. These sales could not have been exempt pursuant to regulation A+ because Med-X had not complied with the Regulation's terms.

Based upon Med-X's failure to file the annual report, the Commission entered an order in September 2016 temporarily suspending the company's exemption. Med-X has requested a hearing. At the hearing, the Division will demonstrate both of Med-X's related violations—the company's failure to file the required annual report, and the subsequent unlawful sale of securities. The Division will also demonstrate how, under the applicable rules, each violation provides a basis to impose a permanent suspension of Med-X's Regulation A+ exemption from registration. The Division expects that Med-X will endeavor to counter this showing with evidence that its violations of the requirements of Regulation A+ resulted from an error by its attorney. However, as explained below, attorney error is not a defense to a Regulation A+ violation. Accordingly, the Division will seek a permanent suspension of Med-X's Regulation A+ offering.

II. FACTS

A. Background of Regulation A+

Pursuant to the Jumpstart Our Business Startups ("JOBS") Act, passed in 2012, the SEC was mandated by Congress to update and expand Regulation A of the General Rules and Regulations (the "Rules") under the Securities Act of 1933 (the "Securities Act") to allow offerings of up to $50 million of securities within a 12-month period, to require companies to file annual audited financial statements with the SEC, and to adopt additional requirements and conditions that the Commission determines necessary.[1] The goal of the JOBS Act was to

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[1] Regulation A Rules, as amended, are found at 17 C.F.R. § 260.251 through 17 C.F.R. § 260.263.

"increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies."[2]

Under Section 5 of the Securities Act, a company must have a registration statement in effect as to a security before it can sell the security, unless it can rely upon an exemption from registration. 15 U.S.C. § 77e. Prior to the JOBS Act, Regulation A provided an exemption for public offerings of securities up to $5 million annually. On March 25, 2015, the SEC adopted the Rules, collectively (and hereinafter) referred to as Regulation A+, mandated by the JOBS Act. The Rules were designed to provide a "workable path to raising capital that also provides strong investor protections."[3] Regulation A+ created two tiers of offerings: Tier 1 consists of securities offerings up to $20 million in a twelve month period (with not more than $6 million in offers by selling security-holders that are affiliates); Tier 2 consists of offerings up to $50 million in a twelve-month period (with not more than $15 million in offers by selling security-holders that are affiliates). Rule 251(a). No sale of a security may be made under Tier 1 or Tier 2 until an offering statement on Form 1-A has been qualified. Rule 251(d)(2). State registration and qualification requirements are preempted for issuers raising capital under Tier 2. Rule 256.

Regulation A+ imposes heightened investor protections on Tier 2 offerings, including subjecting Tier 2 issuers to more extensive reporting requirements than Tier 1 issuers. To that end, Tier 2 issuers are required to file annual reports on Form 1-K[4] for the fiscal year in which the offering became qualified, and every fiscal year thereafter. Rule 257(b)(1). The annual reports must be filed within 120 calendar days after the end of the fiscal year covered by the report. Form 1-K, General Instructions, ¶ A. (2). Tier 2 issuers must also file semiannual reports

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2 JOBS Act preamble, Pub. L. No. 112-106, H.R. 3606, 112th Congress (2012).

3 SEC Adopts Rules to Facilitate Smaller Companies' Access to Capital, SEC Press Release 2015-49, dated March 25, 2015.

4 17 C.F.R. § 239.91.

on Form 1-SA covering the first six months of each fiscal year. Rule 257(b)(3). A Tier 2 issuer may only sell securities on a continuous basis if the issuer is current in the annual and semiannual filings required of Tier 2 issuers pursuant to Rule 257(b). Rule 251(d)(3)(i)(F). Additionally, audited financial statements are required in the offering documents and the annual reports for Tier 2 offerings. General Instructions to Form 1-A, Part F/S, (c)(1)(ii); Form 1-K, Part II, Item 7.

B. Med-X's Regulation A+ Exemption was Qualified

Med-X is a California-based start-up company formed in 2014 with the stated objectives of publishing content (mostly online) about the cannabis industry, engaging in research and development regarding medicinal uses of cannabis extracts, and selling natural products supporting the growth of cannabis plants. As a United States corporation, Med-X is an eligible issuer, and its common stock is an eligible security under Regulation A+. Rules 251(b)(1) and 261(c).

At the hearing on this matter, the evidence will establish the following events:

- On August 27, 2015, Med-X filed a Form 1-A Tier 2 Regulation A+ Offering Statement to sell $15 million shares of common stock at $0.60 per share. (DIV Ex. 1.) This filing stated that the securities would be offered on a continuous basis and the offering would terminate on March 15, 2016, unless extended up to an additional 180 days or terminated sooner.
- On September 28, 2015, the Division of Corporation Finance sent a letter to Med-X CEO David Toomey, requesting Med-X revise the use-of-proceeds discussion in its Form 1-A Offering Statement. (DIV Ex. 2.)

- On October 15, 2015, Med-X filed a Form 1-A/A amending its Offering Statement to revise the use-of-proceeds discussion and extend the offering to April 12, 2016, unless it was extended an additional 180 days or terminated. (DIV Ex. 3.)
- On October 30, 2015, Med-X President Matthew Mills sent a letter to the SEC requesting that the SEC declare its Offering Statement on Form 1-A to be qualified on November 3, 2015 at 10:00AM Eastern Time. (DIV Ex. 4.)
- On November 3, 2015, the SEC staff, pursuant to delegated authority from the Commission, issued a Notice of Qualification of the offering as requested. (DIV Ex. 5.)
- Med-X filed extensions of the termination date of the offering, the last of which extended the termination date to October 14, 2016. (DIV Ex. 6.)

C. Med-X Failed to File its Annual Report and Continued Selling Securities After the Date the Report Was Due

Because Med-X's Regulation A+ exemption was qualified in 2015, Med-X was required to file its annual report by April 30, 2016—120 calendar days after the end of the fiscal year (December 31, 2015) in which the Tier 2 offering became qualified.[5] Rule 257(b)(1); Form 1-K, General Instructions, ¶ A.(2). Because Med-X was not a registered entity, it was not providing investors with the type of financial information contained in 10-Qs and 10-Ks. This made Med-X's first annual report particularly important.

In a Regulation A+ Offering Statement dated August 24, 2015, and filed with the SEC on EDGAR[6] on August 27, 2015, as well as in an Amended Offering Statement filed with the SEC

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[5] Med-X's Form 1-A reveals that the company's financial statements are prepared on a calendar year basis ending December 31. (DIV Ex. 1.)

[6] As the Court is aware, EDGAR is the SEC's Electronic Data Gathering, Analysis, and Retrieval system.

on October 15, 2015, Med-X represented that, "We will furnish each shareholder, *within 120 days after the end of each fiscal year*, our audited financial statements in an Annual Report on Form 1-K filed with the Securities Exchange Commission...." (DIV Ex. 1; DIV Ex. 3; Emphasis added.) Both filings were signed by the Executive Officers and Directors of Med-X, reflecting actual knowledge of when the Annual Report was due.

Med-X's annual report was due to be filed on April 30, 2016. Subsequent to that date, the SEC's Division of Corporation Finance determined that Med-X's annual report for fiscal 2015 was not on file on the SEC's EDGAR system. Relating to this failure, the evidence will also establish the following:

- On August 30, 2016, Division of Corporation Finance staff notified Med-X in writing that it had failed to comply with the requirement that it file an annual report on Form 1-K. (DIV Ex. 7.) The letter further advised Med-X of the possibility, without further notice, of a temporary suspension of the Regulation A+ exemption under 17 C.F.R. § 230.258.
- On September 6, 2016, counsel to Med-X called the Division of Corporation Finance and left a voice message acknowledging that the report had not been filed and indicating that it would be filed "within the next couple of weeks." (DIV Ex. 8.)
- On September 16, 2016, the SEC entered an Order temporarily suspending Med-X's Regulation A+ exemption based upon its failure to file an annual report. (DIV Ex. 9.)
- On September 20, 2016, Med-X filed the delinquent 2015 annual report as well as its semiannual report for the first half of 2016. (DIV Exs. 11 and 12.)
- From April 30, 2016— the date that Med-X's annual report was due and the date after which the company was prohibited from selling securities because its annual report

was not filed—through September 27, 2016, Med-X continued to sell shares of unregistered Med-X stock. Over the four-month period following April 30, 2016, Med-X sold 403,030 shares of stock to 150 investors for a total of $241,818. (DIV Ex. 16A-C.)

In the October 24, 2016 Joint Prehearing Statement, the Division provided notice of the additional basis for Med-X's liability in this proceeding. Specifically, the Division informed Med-X that selling a significant number of shares of stock after the required annual report was due provided a further basis for liability. Joint Prehearing Statement, ¶ 11.

III. ARGUMENT

A. Regulation A+ Legal Standards

1. Mandatory Annual Report Filing for Tier 2 Issuers

Rule 257 is clear that qualified Tier 2 issuers such as Med-X must file an "annual report on Form 1-K for the fiscal year in which the offering statement became qualified" and that the report "must be filed within the period specified in Form 1-K." Rule 257(b)(1). The General Instructions to the Form 1-K provide clear and explicit guidance to an issuer relying on the Regulation A+ exemption. Specifically, near the top of the Form 1-K, in the General Instructions, the filer is instructed that the Form "shall be used for annual reports pursuant to Rule 257(b)(1) of Regulation A." Form 1-K ¶ A (1). Just below this, the Form 1-K unequivocally states that "Annual Reports on this Form shall be filed within 120 days after the end of the fiscal year covered by the report." *Id.* ¶ A (2). Because its offering was qualified in November 2015, Med-X was required to file its annual report by April 30, 2016.

Regulation A+ Rules establish that if an issuer conducting a continuous Tier 2 offering is not current in its reporting requirements, it is not permitted to sell securities in reliance on the

exemption. Specifically, Rule 251(d)(3)(i)(F) states that in continuous offerings, such as the Med-X offering, securities may be sold "*only if the issuer is current in its annual and semiannual filings pursuant to Rule 257(b), at the time of such sale.*" (Emphasis added.)

Thus, an annual report on Form 1-K must be filed within 120 days after the end of the fiscal year in which the offering statement is qualified; and if the annual report is not timely filed, the issuer is prohibited from selling its securities. These requirements are plainly stated and explicitly clear.[7] Here, Med-X did not file the required annual report, and sold a significant volume of stock to investors during a time in which it was prohibited from selling such securities.

2. Rule 258 Suspension Proceedings

In a proceeding initiated pursuant to Rule 258, the Commission may enter an order temporarily suspending a Regulation A+ exemption if it has reason to believe that "any of the terms, conditions or requirements of Regulation A have not been complied with." Rule 258(a)(1). Once the Commission enters a temporary suspension order, it must promptly give notice to the issuer that it may, in writing and within 30 days of the entry of the order, request a hearing. Rule 258(b)(2).

"Where a hearing is requested or is ordered by the Commission, the Commission *will*, after notice of and opportunity for such hearing, *either vacate the order or enter an order permanently suspending the exemption.*" Rule 258(c). (Emphasis added.) Furthermore, after notice and opportunity for hearing, the Commission may "enter an order permanently suspending

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[7] The required time to file the annual report is stated at the beginning (third and fourth lines) of the Form 1-K General Instructions.

the exemption for *any reason upon which it could have entered a temporary suspension order under paragraph (a) of this section.*" Rule 258(d). (Emphasis added.)

3. The SEC Intended that a Significant Deviation from the Regulation A+ Rules Should Result in the Loss of an Exemption

In promulgating Regulation A+, the SEC determined that certain "insignificant deviations" from Regulation A+ would not necessarily result in the loss of the issuer's exemption from the requirements of Section 5 of the Securities Act. Rule 260(a).[8] In addition to defining the method for identifying insignificant deviations, Rule 260 provides that any failure to comply with certain requirements of Rule 251 "*shall be deemed to be significant to the offering as a whole.*" Rule 260(a)(2). (Emphasis added.) Among the requirements the rule deems to be significant are the requirements of Rule 251(d)(3)(i)(F) governing continuous offerings: "Securities may be sold . . . only if the issuer is current in its annual and semiannual filings pursuant to Rule 257(b), at the time of such sale." Rule 260(a)(2); Rule 251(d)(3)(i)(F). The Regulation A+ requirements Med-X failed to meet are thus without question significant deviations from the requirements.

The Commission explicitly intended and unequivocally articulated that significant deviations would result in the loss of the Regulation A+ exemption. Specifically, the Commission stated in the Regulation A+ adopting release that the final Rules:

> *explicitly classify as significant those deviations* that are related to issuer eligibility, aggregate offering price, offers and *continuous or delayed offerings.* This provision benefits investors by providing certainty about the provisions *from which the issuer may not deviate without losing the exemption.* At the same time, it enables issuers to continue to rely on the exemption and obtain its capital formation benefits even if they have an "insignificant deviation" from the final rules. This provision may be especially beneficial for issuers with limited experience with Regulation A offerings as their limited experience may make them more susceptible to an inadvertent error.

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[8] Rule 260(c) states that it provides no relief or protection to a respondent from a proceeding under Rule 258.

SEC Amendments for Small and Additional Issues Exemptions under the Jobs Act, Release No. 33-9741, at 310-11 (June 19, 2015), *available at* https://www.sec.gov/rules/final/2015/33-9741.pdf (Emphasis added.) The Commission further stated:

> The provisions of Regulation A regarding issuer eligibility, offering limits, offers, and continuous or delayed offerings of Regulation A are deemed to be significant to the offering as a whole, and *any deviations from these provisions result in the issuer's loss of the exemption. Id.* at 197. (Emphasis added.)

In adopting Regulation A+, the Commission fully considered the competing goals of promoting small business growth and protecting investors, weighing the consequences of both insignificant and significant deviations from the requirements of the Rules, including the possibility of inadvertent errors based on the limited experience of issuers using the exemption.[9] The SEC then promulgated rules that carefully balanced the various interests and equities associated with the privilege of—not an entitlement to—an exemption to Section 5 registration.

Thus, once an issuer violates Regulation A+ Rules that are significant—which the rules violated by Med-X indisputably are—the explicit intent of the Commission is that the violations will result in the issuer losing the exemption.[10]

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[9] The Commission explicitly rejected some commenters' suggestions that the Commission alter its proposed handling of significant and insignificant deviations, stating:

> We believe that provisions for insignificant deviations serve an important function by allowing for certain errors that can occur in the offering process, while clearly delineating those provisions from which an issuer may not deviate. We believe the current provisions provide assurances to investors that issuers will not be able to deviate from certain fundamental requirements in the rules and avoid undue hardship that could befall issuers for inadvertent errors, such as loss of the exemption and, with respect to Tier 2 offerings, the loss of preemption of state securities law registration and qualification requirements.

Id. at 199.

[10] This is unlike other areas of the securities laws, such as in Exchange Act Section 12(j) proceedings where public interest factors must be analyzed. *See, In the Matter of Gateway Int'l*

B. Med-X's Failures to Meet the Requirements of Regulation A+ Warrant Permanent Loss of its Exemption

The parties have agreed that there are three issues for the Court to determine at the hearing:

- Whether Med-X failed to file its annual report for fiscal year 2015 by April 30, 2016—120 calendar days after the end of its fiscal year—in violation of Rule 257(b)(1) of Regulation A;
- If Med-X failed to timely file its annual report for fiscal year 2015, whether it sold securities while no current annual report was on file, in violation of Rule 251(d)(3)(i)(F) of Regulation A; and
- If liability is established, what is the appropriate remedy.

Joint Prehearing Statement, ¶ 1.

Notably, it is not clear whether, or to what extent, Med-X will dispute the first two issues. Indeed, Med-X has stipulated that it filed its 2015 annual report on September 20, 2016, and that it sold more than 400,000 shares of stock between May 1, 2016, and the date it filed its report. *Id.* ¶ 4. Nor does the Division anticipate that Med-X will contest that its annual report was due on April 30, 2016.

The Division will demonstrate that in Med-X's October 30, 2015 letter, filed on EDGAR, Med-X requested that the SEC declare its Offering Statement on Form 1-A to be qualified by November 3, 2015. (DIV Ex. 4.) The SEC granted that request. (DIV Ex. 5.) Thus, Med-X was required by Regulation A+ to file an annual report on Form 1-K, within the period specified

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Holdings, Inc., Exchange Act Release No. 34-53907, 88 SEC Docket 334, 2006 WL 1506286 (2006). With respect to Regulation A+ proceedings, the Commission unquestionably determined the appropriate balancing of public interest factors and provided for reprieve from a permanent suspension only in limited cases of insignificant deviation.

in Form 1-K, *i.e.,* 120 days from December 31, 2015, the end of the fiscal year in which the offering statement was qualified. Med-X did not do so, and instead, filed it four months late, on September 20, 2016. Joint Prehearing Statement, ¶ (4).

During the four-month period after its annual report was required to be filed, Med-X sold a significant number of shares to investors worth approximately $241,818.[11] Those investors did not have access to current, required information about Med-X, including current audited financial statements. There will therefore be no question that Med-X failed to comply with the requirements of Regulation A+.

Regarding the appropriate remedy, the evidence that Med-X violated significant provisions of Regulation A+ requires the loss of the exemption. Med-X will likely argue that a permanent suspension is too harsh. However, as discussed above, this would ignore the explicit language—as well as the clear intent—of the Regulation A+ Rules adopted by the Commission: significant deviations from the rules, which unequivocally occurred here, will result in the issuer losing the exemption. The Regulation A+ Rules state that (1) failing to timely file an annual report, and (2) selling stock while not in compliance with this requirement, are both significant. Indeed, the Division will demonstrate that approximately 150 investors bought Med-X stock without the benefit of the information mandated by the Commission to be contained in a timely annual report.

In sum, after the hearing there will be no question that Med-X violated the "terms, conditions and requirements" of Regulation A+ by failing to file its annual report, and by engaging in substantial sales of stock during the four-month period that its annual report was

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[11] At the hearing, the Division will introduce evidence regarding the sales of stock Med-X made during the violation period. This evidence, which Med-X provided to the Division, indicates that Med-X appears to have sold slightly less stock than it stipulated in the Joint Pretrial Statement.

delinquent. These requirements are at the heart of Regulation A+. The importance of these requirements is demonstrated by the compulsory language used in the Rules—the issuer *must* file an annual report, the annual report *must* be filed within the time period specified, and the issuer may sell its stock *only* if its annual report is on file at the time of sale. Rules 257(b) and 251(d)(3)(i)(F). The Commission's explicit directive that violations of these requirements be deemed significant compels the permanent suspension of Med-X's exemption.

C. The Court Should Decline to Admit or Consider any Evidence that Med-X's Failure to Comply with Regulation A+ was the Fault of its Attorney

The Division of Enforcement has learned that Respondent Med-X intends to present at the hearing in this matter—either as a substantive affirmative defense, or in mitigation relating to the appropriate remedy—evidence that its failures to comply with the requirements of Regulation A+ resulted from inadvertent acts or omissions, which were based on erroneous legal advice that principals of the company received from their attorney[12] (and former Med-X director) Mark Richardson.[13] This Court should enter an order preventing Med-X from presenting this type of evidence for two reasons. First, scienter is not an element of a Regulation A+ violation, and evidence relating to Med-X's intent or state of mind (*e.g.*, they were innocently relying on advice

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[12] In response to Judge Patil's Order of December 2, 2016, Med-X produced no documents which support an advice of counsel defense.

[13] According to Med-X's SEC filings, attorney Mark Richardson has held various positions within and outside the company. For instance, in the company's Offering Circular, Med-X specifically states that attorney Mark Richardson "is General Counsel to the Company, but is not an employee, officer or director of the Company." (DIV Ex. 1 at DIV000055) However, in the financial documents attached to the filing, Med-X expressly noted that—as of December 2014—"Mark Richardson of the law firm Richardson & Associates, a director and shareholder of the Company, provides legal services related to SEC activities to the Company at no charge." *Id.* at DIV000078. Mr. Richardson is identified as owning 5.48% of Med-X's shares prior to the offering at issue in this matter. *Id.* at DIV000055. This is the equivalent share of the company's stock that was owned by Director and Chief Financial Officer Ronald Tchorzewski. The five million shares of Med-X that Richardson owns are "founder's common stock." *Id.*

of their legal counsel) is thus irrelevant and not available as an affirmative defense to the allegations.[14] Second, to the extent Med-X seeks to introduce evidence that its failures were the fault of its counsel—not as an affirmative defense against liability, but for some other purpose—the evidence would also be irrelevant because, as discussed above in Section A.3, the Commission's unambiguous intent in promulgating Regulation A+ was that significant deviations from the regulation's requirements, such as those committed by Med-X, would necessarily result in a permanent suspension of the exemption. [15]

It is well settled that the Federal Rules of Evidence do not apply in SEC administrative proceedings.[16] Indeed, under SEC Rule of Practice 320, the term "relevance" is construed much more "broad[ly] than" is the case "under the Federal Rules of Evidence." *City of Anaheim*, 1999 SEC LEXIS 2421 at *4. The SEC's administrative law judges ("ALJ") are therefore "inclusive in making evidentiary determinations." *Id.* However, in administrative proceedings Rule 320(a) directs that while ALJs "*may* receive relevant evidence" they "*shall* exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unreliable." 17 C.F.R. § 201.320. (Emphasis

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[14] Affirmative defenses are defined as "[a] defendant's assertion of facts and arguments that, if true, will defeat the plaintiff's or prosecution's claim, even if all the allegations in the complaint are true." Black's Law Dictionary (10th ed. 2014).

[15] As discussed in the Division's motion *in limine*, Med-X will endeavor to counter this evidence with an expert report by Gerald J. Laporte, Esq. The Court should strike this report and preclude Mr. Laporte from testifying because the report (1) provides no "expertise" beyond legal argument, which Med-X may make in briefs, and (2) fails to take into account the significant fact that substantial sales occurred while Med-X was in violation of Regulation A+. Therefore, its conclusions regarding an appropriate remedy are wholly irrelevant.

[16] *See, Del Mar Fin. Servs., Inc.*, Exchange Act Release No. 8314, 2003 SEC LEXIS 2538, at *28 (Oct. 24, 2003), *recons. denied*, Securities Act Release No. 8386, 2004 SEC LEXIS 331 (Feb. 17, 2004); *see also, City of Anaheim*, Exchange Act Release No. 42140, 1999 SEC LEXIS 2421, at *4 (Nov. 16, 1999) ("The Federal Rules of Evidence . . . do not apply to administrative adjudications."—citing *Opp Cotton Mills, Inc. v. Adm'r*, 312 U.S. 126, 155 (1941)).

added). Because it is irrelevant to this matter, the Court should disallow any advice of counsel evidence Med-X may seek to introduce.

Section 5 imposes strict liability on sellers of securities in unregistered transactions. *SEC* v. *Phan,* 500 F.3d 895, 902 (9th Cir. 2007); *M&A West Inc.,* No. C-01-3376 VRW, 2005 WL 1514101 at **8-9. Therefore, to prove a violation of Section 5, a plaintiff need not establish scienter. *See SEC v. Universal Major Indus.,* 546 F.2d 1044, 1047 (2d Cir. 1976); *SEC v. Softpoint, Inc.,* 958 F. Supp. 846, 859–60 (SDNY 1997) (Sotomayor, J.); *SEC v. Rosen*, No.01-0369-CIV, 2002 WL 34421029, at *3 (S.D. Fla. Feb. 22, 2002).

Courts have held that, where scienter is an element of a claim, a defendant may introduce evidence that he or she relied on the advice of counsel in order to rebut the SEC's allegations that he or she acted with *scienter*. *See, e.g*, *Howard v. SEC,* 376 F.3d 1136, 1147–48 (D.C. Cir. 2004) ("reliance on the advice of counsel need not be a formal defense; it is simply evidence of good faith, a relevant consideration *in evaluating a defendant's scienter*.") (Emphasis added.)

Thus, if a defendant's scienter is not an element of the SEC's claim, as is the case here, then evidence of a defendant's purported reliance on counsel—whether it is advice of counsel, lack of advice of counsel, or mistake of counsel—is not a permissible defense.[17] This is well-

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[17] In cases where reliance on advice of counsel is permissible, it is axiomatic that to establish the defense the defendant must show: (1) the defendant made a complete disclosure to the professional, (2) that the defendant sought the advice of the professional as to the appropriateness of the challenged conduct, (3) that the defendant received the professional's advice that the conduct was appropriate, and (4) that the defendant relied on that advice in good faith. *E.g.*, *Markowski v. SEC*, 34 F.3d 99, 104–05 (2d Cir. 1994); *SEC v. Goldsworthy*, Civil Action No. 06–10012–JGD, 2008 WL 8901272, at *4 (D. Mass. June 11, 2008); *SEC v. Caserta*, 75 F. Supp. 2d 79, 95 (EDNY 1999). The defense fails where any of these elements are not proven. Med-X apparently will not even attempt to meet any of the elements, much less all four. Nor could it; because the legal "advice" purportedly relied on by Med-X was not "advice" at all.

A mistake by counsel provides Med-X with no basis to avoid a permanent suspension. It must be presumed that Med-X knew that which could have been easily ascertained, such as by

established. The Commission specifically so held in *In the Matter of Rodney R. Schoemann*, when it rejected the respondent's advice of counsel defense, finding that his reliance on an attorney opinion letter was of no consequence because "Section 5 of the Securities Act is a strict liability provision, and good faith is not a valid defense." Exchange Release No. 33-9076, 2009 WL 3413043, at *12 (Commission Opinion Oct. 23, 2009, *aff'd*, 398 F. App'x 603 (D.C. Cir. 2010) (*per curium*).

Federal court decisions are in accord. *See e.g., SEC v. Current Fin. Services,* 100 F. Supp. 2d 1, 5-6 (D.D.C. 2000) (defendant who sought and received incorrect legal advice that a transaction was exempt from registration was still found liable for violating Section 5 because scienter and reliance on advice of counsel are irrelevant); *SEC v. Novus Technologies, LLC*, No. 2:07-CV-235-TC, 2010 WL 4180550 at *12 (D. Utah Oct. 20, 2010) (holding defendant could not avoid liability based on a good faith belief that the offer or sale was legal; nor could he rely on advice of counsel to defend against Section 5 claim because Section 5 imposes strict liability);

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reading the few pages of rules that comprise the very regulation pursuant to which it was seeking to raise capital. Further, as long established in the law, a person voluntarily chooses its attorney as his representative, and he cannot later "avoid the consequences of the acts or omissions of this freely selected agent. *** each party is deemed bound by the acts of his lawyer-agent and is considered to have 'notice of all facts, notice of which can be charged upon the attorney.'" *Link v. Wabash R.Co.*, 370 U.S. 626, 633-34 (1962), (quoting *Smith v. Ayer,* 101 U.S. 320, 326 (1879)). As the Supreme Court in *Link* also noted:

> [I]f an attorney's conduct falls substantially below what is reasonable under the circumstances, the client's remedy is against the attorney in a suit for malpractice....[T]his Court's own practice is in keeping with this general principle. For example, if counsel files a petition for certiorari out of time, we attribute the delay to the petitioner and do not request an explanation from the petitioner before acting on the petition.

Id. at n. 10.

Swenson v. Engelstad, 626 F.2d 421, 424 (5th Cir. 1980); ("The Securities Act of 1933 imposes strict liability on offerors and sellers of unregistered securities . . . regardless of . . . any degree of fault, negligent or intentional, on the seller's part.")

In S*EC v. Cavanagh*, for example, certain defendants contended that they were entitled to rely on the advice from their counsel that a valid registration statement was in effect or that an exemption was available. No. 98 Civ. 1818 DLC, 2004 WL 1594818, at *17 (SDNY 2004), *aff'd* 445 F. 3d 105 (2d Cir. 2006). The court held that the claimed advice of counsel "provided no protection against a violation of a strict liability statute like Section 5." *Id.* Of note, in an earlier opinion in the case, the court held that "Cavanagh could not reasonably have expected [his counsel] to render an independent opinion as to the legality of the transaction given his personal involvement in structuring it and his financial stake in its completion." *SEC v. Cavanagh*, 1 F. Supp. 2d 337, 374 (SDNY 1998).[18] Accordingly, an advice-of-counsel defense here is irrelevant and therefore inadmissible.

Relatedly, the Court should likewise preclude evidence that Med-X's failures to comply with the requirements of Regulation A+ render it somehow less culpable (and thus, not warranting a permanent suspension) because the violations resulted from the inadvertent error of their attorney. As discussed above, the commentary to the Regulation A+ Rules makes clear that the Commission was aware that undue hardship could befall issuers for inadvertent errors. However, in striking the balance between protecting investors and avoiding undue hardship to issuers, the Commission determined that only insignificant errors could, in certain circumstances, avoid loss of the exemption. When the issuer's deviations are significant,

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[18] As noted above at n. 13, attorney Mark Richardson holds a major stake in Med-X, and is listed as a Principal Shareholder of the firm in the Offering Circular Med-X filed in connection with the offering at issue in this matter. (DIV Ex. 1.)

whether inadvertent or otherwise, the Commission determined that protecting investors outweighs the hardship to the issuer. The language of the Rules and the accompanying commentary reflecting the Commission's intent thus militate strongly against the admission of advice-of-counsel evidence.

Issuers have the responsibility to either register their securities offerings under the Securities Act, or be aware of and comply with the requirements necessary to establish and maintain an exemption from the registration requirements. It was Med-X's own failure to file the required annual report in a timely manner, and it was Med-X that engaged in a significant volume of stock sales even though the annual report had not been filed, thereby depriving investors of significant information clearly required by the SEC's rules. Stated simply, it was Med-X's responsibility to comply with the requirements of Regulation A+, and it is Med-X that is responsible for the loss of its exemption—with no room for escape based on mistakes by its appointed agent. It cannot be that an issuer is able to avoid the consequences of the clear and precise requirements of Regulation A+ by shifting the blame for its failed responsibility to its agent or asserting the hardship that would result from a permanent loss of the exemption. [19]

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[19] As noted above, Med-X had actual knowledge of its obligation under Regulation A+ to file an annual report on Form 1-K—the form specifically required by Regulation A+ -- within 120 days after the end of the fiscal year in which the offering was qualified. Specifically, in Med-X's Regulation A+ Offering Statement, dated August 24, 2015, and filed with the SEC on EDGAR on August 27, 2015, Med-X specifically represented that:

> We will furnish each shareholder, within 120 days after the end of each fiscal year, our audited financial statements in an Annual Report on Form 1-K filed with the Securities Exchange Commission.

(DIV Ex. 1.) Med-X said the same thing in its Amended Offering Statement filed with the SEC on October 15, 2015. (DIV Ex. 3.)

Accordingly, the Court should preclude Med-X from introducing evidence at the hearing relating to any reliance it may have placed on the advice Mr. Richardson provided the company.

IV. CONCLUSION

As demonstrated, there are only two possible remedies available in a Rule 258 proceeding: vacating the suspension or making the suspension permanent. Both the language and stated intent of Regulation A+ make it clear that a permanent suspension is the appropriate remedy once liability is established. Accordingly, the Division respectfully submits that a permanent suspension is compelled in this case.

Dated: January 4, 2017

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CERTIFICATE OF SERVICE

I hereby certify that a true copy of the Division of Enforcement's Pre-Hearing Brief was served on the following on this 4th day of January, 2017, in the manner indicated below:

By Electronic Mail:

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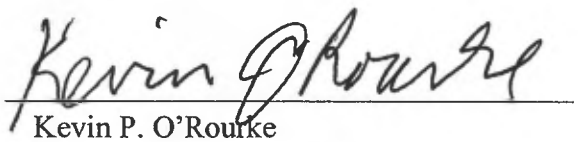

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