UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17551

In the Matter of	
Med-X, Inc.	
Respondent.	

DIVISION OF ENFORCEMENT'S POST-HEARING MEMORANDUM

March 21, 2017

Kevin P. O'Rourke
Joshua E. Braunstein
Nancy L. Singer
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

COUNSEL FOR THE DIVISION
OF ENFORCEMENT

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I. INTRODUCTION

After the hearing in this matter, there is no question that Med-X, Inc. ("Med-X") committed multiple violations of key requirements of Regulation A+. For instance, there is no dispute that Med-X failed to timely file its annual report, thus depriving investors of the information required to be disclosed in the annual report. Nor is there any dispute that Med-X sold a significant amount of stock when it was prohibited from doing so under Regulation A+ rules, or that these sales constituted numerous violations of Section 5 of the Securities Act of 1933 ("1933 Act"). Permanent suspension of Med-X's Regulation A+ exemption is therefore amply warranted here, not least because the flexibility provided in Regulation A+ to Tier 2 issuers like Med-X was explicitly premised on the Commission's decision to require issuers to timely file periodic reports to investors. Med-X's failure to adhere to its reporting obligation and its unlawful sales of stock undermined significant investor protections underlying the Regulation A+ regime.

Med-X seeks to avoid a permanent suspension by asking the Court to conclude that its violations resulted from a single error by its attorney, who the company maintains misinterpreted (or was unaware of) the requirement governing the time for filing the annual report as a Tier 2 issuer. Med-X contends that—in light of the legal analysis in cases in which the Commission weighed whether to suspend or revoke an issuer's *registration*—this error by its attorney provides a basis to avoid permanent suspension.

But Med-X is wrong both on the facts and the law. As to the facts, Med-X's central premise ignores that it admittedly sold more than $240,000 of stock to 150 investors during a four-month period when it was prohibited from doing so under Regulation A+ rules, and that these sales also constituted numerous violations of Section 5. Med-X also ignores other key

facts relating to its Regulation A+ offering, which further support an order of permanent suspension, including: (1) Med-X continued selling stock to new investors after learning that its annual report was delinquent, despite the rule's clear prohibition against doing so—indeed, it even continued selling stock *after* a temporary suspension was entered by the Commission; (2) Med-X knew that it faced potential suspension of its Regulation A+ exemption—and later that its exemption was temporarily suspended—yet it chose not to disclose this to investors in its annual report, and (3) Med-X's president and founder's testimony was inconsistent, not credible, and betrayed his indifference to disclosure rights of investors—all of which casts substantial doubt on the company's assurances that it would comply with its disclosure requirements in the future.

As to the law, first, Med-X glosses over the key differences between an exemption and a registration statement. In doing so, Med-X ignores that, unlike a registration case, a Regulation A+ exemption is a privilege which may be lost upon a failure to strictly comply with its requirements (Med-X has not complied with the requirements of Regulation A+). Thus, the Court should reject as inapposite Med-X's comparisons to unrelated law that was developed under a different statutory scheme and for a different purpose. Further, as to its reliance on its attorney, the company's intent here is not relevant. Even *assuming* a single error, whether the error was inadvertent does not affect the significance of the company's deviations from its obligations. Neither an ostensible reliance on advice of its counsel nor the mistake of its counsel provides a defense here. Accordingly, an order permanently suspending Med-X's Regulation A+ exemption is the only appropriate outcome.

II. FACTS

A. Background of Regulation A+

Pursuant to the Jumpstart Our Business Startups ("JOBS") Act, passed in 2012, the Commission was mandated by Congress to update and expand Regulation A of the General Rules and Regulations under the 1933 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 Commission, and to adopt additional requirements and conditions that the Commission determines necessary.[1] The goal of the JOBS Act was to "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 amending Regulation A (which became known 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

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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. References herein to either Regulation A or Regulation A+ generally refer to the amended version, with exceptions that are evident from context (*e.g.*, cases that predate the amendments).

[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.

$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 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. Summary of the Case

Med-X, Inc. ("Med-X") is a California-based start-up company, incorporated in Nevada in 2014. According to Med-X's public statements, it wanted to raise capital to: (1) publish a Cannabis industry media platform, www.marijuanatimes.org, (2) sell Nature-Cide, a natural

[4] 17 C.F.R. § 239.91.

insecticide, to Cannabis cultivators, and (3) conduct research and development of medical supplements made from Cannibis. (DIV Ex. 1, DIV0022, DIV0086.)

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 on a continuous basis, to terminate on March 15, 2016. (DIV Exs. 1 and 20.) Following a request by the Division of Corporation Finance to revise the use of proceeds discussion in the Offering Statement and after filing an amended Offering Statement containing its revisions, Med-X made a written request dated October 30, 2015, that the SEC declare its Offering Statement on Form 1-A be qualified on November 3, 2015. (DIV Exs. 1-4.) Pursuant to its delegated authority, the Division of Corporation Finance issued a written Notice of Qualification and posted it on EDGAR qualifying Med-X's offering, as requested, on November 3, 2015. (DIV Ex. 5.)

Because Med-X was qualified in Fiscal Year 2015 to sell its stock, it was required to file an annual report on Form 1-K within 120 days of the commencement of Fiscal Year 2016 or April 30, 2016. (Gomez Tr. 35:24-26:6; Rule 257(b)(1); DIV Ex. 3.) Med-X's Offering Statement committed to furnish shareholders with audited financial statements in its Form 1-K.[5] (DIV Exs. 1and 3, DIV0191.)

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[5] After the Notice of Qualification of its Offering Statement, Med-X filed three post-qualification amendments to its Offering Statement and two supplements, which were posted on EDGAR between November 3, 2015 and July 11, 2016; the last filing extended the offering to October 14, 2016. (DIV Exs. 6 and 20; RES Exs. B-F.) Amendments filed after the Notice of Qualification of the Offering Statement ("post-qualification amendments") do *not* change the date that the annual report is due to be filed. Rule 257 states that the annual report must be filed for the fiscal year in which the offering became qualified. Post-qualification of an amendment simply qualifies the amendment; it does not change the qualification date of the original Offering Statement (Gomez Tr. 42:6-19, 44:15-25; Rule 257(b)(1).) If post-qualification amendments to the offering could change the deadline for filing an annual report, that could result in a company being able to avoid ever filing the annual report—the issuer could perpetually avoid the due date of the annual report by filing post-qualification amendments each year. (Gomez Tr. 43:12-23.)

The Office of Small Business Policy ("OSBP") in the Division of Corporation Finance oversees issuers who had Regulation A+ offerings. OSBP discovered that Med-X failed to file its annual report by April 30, 2016 as Rule 257(b)(1) required. (Gomez Tr. 10:13-7, 34:19-35:7) OSBP further determined that Med-X was engaged in a continuous offering and the securities were being offered through an online portal, StartEngine. (Gomez Tr. 45:21-46:9.)

Tim Henseler, Chief, Office of Enforcement Liaison in the Division of Corporation Finance, sent David Toomey, CEO of Med-X, a letter dated August 30, 2016, advising Med-X that it was not in compliance with the requirement that Regulation A+ Tier 2 issuers file an annual report pursuant to 17 C.F.R. § 230.257(b)(1) within 120 calendar days after the end of its fiscal year, and that the Commission may issue a temporary suspension order, without further notice, at any time. Med-X received the letter on September 2, 2016. (Gomez Tr. 47:13-24; RES Ex. G-1.)

On September 6, 2016, Mark Richardson, counsel for Med-X, left a voice message on Henseler's telephone answering machine acknowledging the correspondence, stating that he [Richardson] "was going off the date of the last amendments so I didn't realize we had an annual report due April 30," and indicating that the report would be filed "within the next couple of weeks." (RES Ex. G-3.) As further detailed below, even after Richardson's phone call acknowledging receipt of Henseler's letter notifying Med-X that its annual report was delinquent, Med-X continued to sell its stock in violation of both Rule 251 and Section 5. (DIV Exs. 16A-C.)

On September 16, 2016, the Commission entered an order temporarily suspending Med-X's Regulation A exemption. (DIV Ex. 9 and 9A; Gomez Tr. 83:13-20.) The temporary suspension order was based upon information giving the Commission reason to believe Med-X had failed to file an annual report which, as required by Rule 257(b)(1) and Form 1-K, had been

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This would effectively eliminate the annual report requirement which was mandated by Congress in the JOBS Act. (Gomez Tr. 44:2-6.)

due on April 30, 2016. (*Id.*) On September 20, 2016, Med-X filed its Annual Report for Fiscal Year 2015 on Form 1-K as well as its Form 1-SA Semiannual Report (DIV Exs. 11-12.) OSBP reviewed Med-X's annual report and discovered that Med-X had sold a significant number of shares during the time period its annual report was delinquent, in violation of Rule 251(d). (Gomez Tr. 50:7–17, 83:21-84:14,85:14-86:6.)

The Court held a hearing on January 10 and 25, 2016, to determine whether the temporary suspension issued on September 16, 2016, should be permanent or if Med-X could continue raising money pursuant to Regulation A.

C. Testimony and Documentary Evidence Presented at the Hearing

1. Christopher Reilly

Christopher Reilly, a Financial Economist in the Commission's Division of Economic and Risk Analysis ("DERA"), analyzed investor stock purchases in Med-X's Regulation A offering between April 30, 2016, the date Med-X's annual report was due to be filed, and September 27, 2016, the final date Regulation A shares were sold. (DIV Exs. 15, 16A-C, 17.) Med-X records revealed that 150 investors paid $240,000 for the purchase of approximately 400,000 shares of Med-X stock during this time period. Of the 150 investors who purchased stock in Med-X without current information about the company, 145 investors were investing in Med-X for the first time. (DIV Exs. 15, 16AC, 17; Reilly Tr. 147:2, 148:5-149:7.) Almost one-third of the funds (27%) invested in Med-X's Regulation A offering were provided by investors without the benefit of the required annual report for Fiscal 2015. (Reilly Tr. 149:24-150:2; DIV Ex. 17.) The evidence shows that Med-X continued to sell its securities up to September 27—*after* Med-X had been informed by Henseler's August 30 letter that its annual report was

delinquent, and *after* September 19, the date Med-X had actual notice of the temporary suspension order. (DIV Ex. 16A-16C; RES Ex. G-3; Respondent's Prehearing Brief at 13.)

2. Cesar Sebastian Gomez Abero

Cesar Sebastian Gomez Abero became Chief of the OSBP after passage of the JOBS Act but before the Commission adopted rules implementing the Act. Under his supervision, the OSBP reviewed and analyzed all comments received from the public to the proposed amendments to Regulation A; prepared a summary to inform the Commission as to the views of commenters; and prepared recommendations to the Commission on what became the final rules adopted by the Commission. (Gomez Tr. 14:23-15:14.)

Gomez explained that a basic tenet of securities law is that every offer and sale of securities must be registered under Section 5 of the 1933 Act unless an exemption applies. Registration is the default requirement and exemptions are essentially privileges which allow an issuer to avoid registration if the issuer can meet all of the terms of an exemption. (Gomez Tr. 18:2-11.) There are multiple exemptions to registration, including Regulation A+, Crowdfunding, Regulation D, and Section 4(a)(2) of the 1933 Act. (Gomez Tr. 18:19-25.)

Gomez explained that a permanent suspension of an exemption based upon an issuer's violation of Regulation A+ would cause the issuer to become disqualified under Regulation A+. The resulting five year disqualification would also apply to Regulation D and Crowdfunding, unless the issuer obtained a waiver of the disqualification. Issuers disqualified from using these exemptions would not be foreclosed from relying on other exemptions to conduct offerings, including the private offering exemption under Section 4(a)(2), and they could still make offerings by registering transactions with the Commission. (Gomez Tr. 108:17-109:2, 136:16-137:6.)

Gomez further explained that an issuer that is subject to a permanent Regulation A suspension order may apply for and receive a waiver of disqualification—a process separate from the enforcement action—if the issuer can show good cause for the exemption not becoming unavailable.[6] (Gomez Tr. 52:10-53:22.) If a waiver is granted, an issuer such as Med-X could rely on Regulation D or Crowdfunding to raise capital. (Gomez Tr. 136:16-137:6.) If a waiver is not granted, Med-X would still have available to it the option to register its offering or raise money through a private offering pursuant to Section 4(a)(2). (Gomez Tr. 108:17–109:2.)

3. Matthew Mills

Matthew Mills is the founder of Med-X and has been the company's chairman, president and chief operating officer since its inception in 2014. (Mills Tr. 285:13-18; DIV Ex. 1.) Mills owns approximately 60% of the stock of Med-X. (Mills Tr. 314:16-19.)

Med-X initially raised capital in reliance on Rule 506(c), an exemption from registration, before turning to Regulation A+. Mills spoke as a panelist at a Marijuana Investors Summit about raising funds under 506(c) and Regulation A+. When asked about his expertise with Regulation A+, Mills explained that he does not call himself an expert, but considers himself "proficient" on these topics. (Mills Tr. 311:21-312:5.) Mills testified that Med-X raised "just under $1.2 million" in its Regulation D offering in "a little over a year."[7] (Mills Tr. 287:14-288:4.) Once Regulation A+ became effective, Mills sought to raise money under this exemption because money could be raised more rapidly from a wider variety of investors. (Mills Tr. 288:17-289:2.) He made the minimum investment $420 so it would be attractive to

[6] The Commission has delegated its authority to grant waivers to the Division of Corporation Finance; it has not delegated its authority to deny waivers. (Gomez Tr. 54:16-19.)

[7] A video of his lecture at the Summit revealed that Mills publicly stated that he had raised $1.5 million. (Mills Tr. 300:11- 301:20; DIV Ex. 19.) Mills said he "rounded it up" for the conference. (Mills Tr. 318:9-13.)

everyone. (Mills Tr. 289:7-16.) At the Summit, Mills characterized Regulation A+ as a "game changer" because it allowed Med-X to raise money through general solicitation to the masses while lowering regulatory burdens. At the hearing, he initially described it as "self-governing," (a term he had used to describe Regulation A+ at the Summit) though claimed Med-X did not self-govern, relying on a FINRA member firm to handle "regulatory stuff." (Mills Tr. 305:8-307:5.)

Mills acknowledged that unaccredited investors are less sophisticated than accredited investors and that soliciting investments under Regulation A+ is less cumbersome than under Rule 506(c) which requires verification of investor accreditation. (Mills Tr. 307:8-15.) Mills acknowledged the importance of laws designed to protect less sophisticated investors. (Mills Tr. 307:23-308:6.) Mills claimed to recognize that investors in Med-X were deprived of important information they were entitled to—the annual report— but maintained investors would only look at the offering circular and would not look at periodic filings: "I don't think it would have made any difference." (Mills Tr. 308:18–310:9, 311:16-20.) However, Med-X's annual report for fiscal 2015 reveals, among other things, that its revenue went from $360 in 2014 down to $200 in 2015, while its net loss went from $16,135 in 2014 up to $402,227 in 2015; during 2015 Med-X gave its affiliate, PSH, a $40,000 short-term interest-free loan which was repaid; and in June 2016 Med-X borrowed $50,000 from PSH as a short-term advance which was to be repaid in September 2016. (DIV Ex. 11.)

Mills asserted that there has been dramatic harm to the company as a result of the temporary suspension order. According to Mills, negative media attention caused the broker-dealer to pull out of a "deal" to raise capital. (Mills Tr. 294:23-295:11.) But Mills acknowledged that the contract with the broker-dealer had never been finalized and was still in

negotiations. (Mills Tr. 298:19-23.) Mills stated that Med-X was further harmed by the fact that licenses for cannabis will be issued in 2018, and because of the suspension Med-X will no longer be first to market. (Mills Tr. 295:25-296:4.) Mills further claimed that if the Regulation A+ suspension is made permanent Med-X would be put out of business and investors will lose their money. (Mills Tr. 296:9-12.) However, Mills recognized that if the company received a waiver it could go back to raising money under 506(c); and he acknowledged that Med-X had raised *more* money under Regulation 506(c) than under Regulation A+. (Mills Tr. 296:25-297:15.) Mills also acknowledged that investments in Med-X's Regulation A+ offering, which began in February and continued until the temporary suspension in September 2016, had tapered off by early May 2016. (Mills Tr. 299:5-300:10; DIV Ex. 16A.)

Prior to Med-X, Mills founded PSH, for which he serves as chairman of the board, president and chief operating officer.[8] (DIV Ex. 1, DIV0046.) PSH owns 10 million shares of Med-X and Med-X operates out of PSH office space rent-free. (Mills Tr. 313:14-24.) Mills owns approximately 15% of PSH; other senior officers of Med-X are also officers and shareholders of PSH and, along with Mills, have voting control over PSH. (Mills Tr. 314:20-24; DIV Ex. 1, DIV0017 and 0019.) Nature-Cide, the only product Med-X sells, is owned and manufactured by PSH. PSH granted Med-X an exclusive license to use and market Nature-Cide royalty-free in exchange for the 10 million shares of Med-X stock. (DIV Ex. 1, DIV0022-0023, 0026.)

PSH and Mills were the subjects of a cease and desist order entered in July 2011 by the Pennsylvania Securities Commission ("PA Commission") for cold calling at least one Pennsylvania resident in a "Pre-IPO" investment in shares of PSH. The PA Commission found

[8] PSH's board members are largely the same as Med-X. *Compare* http://www.pac-sh.com/meet-our-board *with* DIV Ex. 11.

Mills and PSH to be in willful violation of the Pennsylvania Securities Act of 1972, Sec. 201 (Registration Requirement—Unlawful Sale of Securities). The PA Commission accepted an offer of settlement by Mills and PSH which included an order to comply with the PA Securities Act and payment of assessments totaling $5000 by Mills and PSH, without admitting or denying the allegations. (DIV Ex. 22.) Mills claimed they had gotten the cease and desist order rescinded, stating that "I don't believe [sic] this finding of fact and that is probably why they [the PA Commission] allowed it to be rescinded," and was averse to acknowledging that the order was rescinded because the PA Commission accepted Mills' offer of settlement. (Mills Tr. 323:4-324:19.)

PSH and Mills were again the subjects of a desist and refrain order entered in August 2013 by the California Department of Business Oversight for offering or selling six million shares of PSH to raise $3 million by cold calling and/or other means of general solicitation, in violation California Corporate Securities Law of 1968 Section 25110 (Qualification and Filing Requirements for Sale of Securities). Mills and PSH were ordered to desist and refrain from the offer or sale of securities unless and until qualified to do so under California law or unless exempt.[9] (DIV Ex. 23.)

Mills claimed that he did not believe the findings of fact of either Pennsylvania or California, or alternatively, that it was his brother-in-law, who worked for PSH and was named in the California order, who committed the violations. (Mills Tr. 315:16-20, 323:4-10, 324:25-326:1, 333:15-20.) Mills further testified "that maybe somebody else made up something" as the source of the allegations. (Mills Tr. 327:11-18.) Mills denied cold calling and, as discussed

[9] Mills initially requested a hearing but the request was withdrawn. (DIV Ex. 23.)

below, made multiple inconsistent statements. (Mills Tr. 315:18-20, 332:6-16, 323:1-10, 326:2-7.)

4. Mark Richardson

Mark Richardson has represented Med-X since its inception in 2014 and was a director until May 2014. (Richardson Tr. 245:16-20, 274:18-19.) He currently holds 5 million founders shares of Med-X, which he received without payment, and stock options. (Richardson Tr. 275:1-17.)

Richardson wrote the documents for Med-X's Regulation A+ offering. (Richardson Tr. 249:9 -11.) Following the filing of a pre-qualification amendment to the offering, he submitted a letter requesting qualification of the offering, and the SEC qualified Med-X's offering in November 2015; Richardson testified that he understood this meant that Med-X could commence selling securities. (Richardson Tr. 251:11-24.) Med-X did not begin selling securities immediately because it was in the process of hiring a broker–dealer to provide compliance services. (Richardson Tr. 251:25-252:20.) Richardson filed three post-qualification amendments to the offering which, according to EDGAR, were qualified on December 4 and 21, 2015, and January 26, 2016. Mr. Richardson was notified of the last amendment qualification on February 3, 2016. (Richardson Tr. 253:4-254:12; DIV Ex. 20.)

Richardson testified that the genesis of his error was that he had in his mind that the first year Med-X would be required to file an annual report was 2016, using February 3, 2016, the date the last post-qualification amendment was qualified—as the key filing date. (Richardson Tr. 257:8-22, 267:19-22.) Richardson stated that the regulations were new and no one had experience with them (Richardson Tr. 257:8-12.) But he acknowledged that he had not looked at the Regulation A+ rules from the time they were promulgated (March 25, 2015) until the day he

received the letter from the SEC informing Med-X of the delinquency (the letter was dated August 30, 2016). (Richardson Tr. 268:14-17; 264:2-7; RES Ex. G-1.) Upon reading the letter from the SEC, Richardson read Rule 257 for the first time since the rules were promulgated (i.e., approximately a year and a half later) and immediately realized the report was due on April 30, 2016. (Richardson Tr. 261:21-262:24; 268:14-17.) Richardson did not look at the instructions to the annual report Form 1-K until he started to prepare the report. (Richardson Tr. 263:18-23.)

5. Gerald Laporte

Gerald Laporte, chief of the OSBP in the Division of Corporation Finance prior to the adoption of the rules implementing Regulation A+ of the JOBS Act, rendered an opinion and prepared a report for Med-X. (Laporte Tr. 153:11-13; RES Ex. I.)

Laporte was asked specifically to opine on: "Whether a permanent suspension of an exemption to registration under Regulation A pursuant to Rule 258 is, in the case of a company that has corrected a single delinquent periodic filing and otherwise has no record of delinquent filings or other extenuating circumstances, consistent with (a) regulatory custom and practice for addressing late periodic report filings, and (b) the statutory scheme and the purpose and intent of Section 401 of JOBS Act?" (Laporte Tr. 169:24-170:11, RES Ex. I at 2.) Laporte opined that a permanent suspension of the Regulation A exemption for a delinquent filing that has been remedied, absent extremely serious extenuating circumstances, would have a chilling effect on the use of Regulation A by small companies to raise capital and could potentially harm the investors. (Laporte Tr. 171:3-14.) He acknowledged that he may have misused the word "extenuating" in referring to other circumstances in his written opinion—he should have said "aggravating" circumstances. (Laporte Tr. 169:15-18, 200:2-9.)

Laporte was asked about the facts upon which he based his opinion. Laporte testified that in forming his opinion, he gave no consideration to the fact that Med-X made prohibited sales of stock; the only fact he was asked to assume was that a single report was late and corrected. (Laporte Tr. 216:23-25, 219:6-11; RES Ex. I.) Laporte testified that he was aware that Med-X sold some shares of stock, but he was "not really familiar with the facts" and he "wouldn't think it's an important fact." (Laporte Tr. 180:20-181:14, 207:2-7.) When confronted with the fact that Med-X sold numerous shares in violation of Section 5, he testified that if he were to reissue his opinion he would state that the numerous violations were not "sufficiently aggravating circumstances." (Laporte Tr. 212:12-18.)

Laporte was asked to read the last sentence of Rule 257(d)(3)(i)(F) and opine on its meaning: "Securities may be sold pursuant to this paragraph (d)(3)(i)(F) only if the issuer is current in its annual and semiannual filings pursuant to Rule 257(b) at the time of such sale." Laporte testified that he was unsure whether this provision prohibited Med-X from selling stock when it was no longer current in its annual filings, stating that "somebody like me, I would not even pay attention to these provisions" and "they [the Commission] sort of stuck it into here in a place that people wouldn't even—you know, experienced securities lawyers wouldn't even look for it here." (Laporte Tr. 203:23-205:14.) However, when Division counsel pointed out to Laporte that the provision is contained in a rule entitled "Scope of the Exemption for Regulation A," Laporte revised his response and acknowledged that a lawyer "would check that." (Laporte Tr. 205:15-20.)

Laporte acknowledged that Med-X had sold 403,000 shares of stock after the annual report was delinquent, and that this occurred at a time when Med-X was precluded from relying on the Regulation A+ exemption; he added that this was "assuming that [the language in Rule

251 proscribing the conduct] is valid law."[10] (Laporte Tr. 208:6-209:22.) Laporte agreed that Section 5 is at the heart of the 1933 Act, that the Commission takes Section 5 very seriously, and that Med-X's sales of stock constituted numerous violations of Section 5. Yet he testified that he did not consider this to be a serious matter: "It's not a big—I mean it happens all the time." (Laporte Tr. 197:17, 210:1-23, 213:12-17.)

Laporte acknowledged that he had not researched any cases relating to violations of Regulation A in drafting his report or preparing for his testimony and cited no cases dealing with the loss of an exemption. (Laporte Tr. 220:12-20, 222:1-11.) Laporte only cited cases relating to companies that have registered classes of shares under the Exchange Act. (Laporte Tr. 222:12-20.) He also acknowledged that registering classes of shares under the Exchange Act and exemptions from registering securities offerings are different. (Laporte Tr. 222:21-223:1.)

Laporte urged the Court to consider extenuating facts and apply the "*Gateway* factors," as discussed below, before permanently suspending an exemption. (Laporte Tr. 178:13-180:6, 185:10-20.) Laporte acknowledged that the *Gateway* factors apply to Exchange Act Section 12(g), not proceedings under Rule 258, but stated his opinion that the factors should apply to Rule 258 proceedings. (Laporte Tr. 179:15-23.) Laporte could cite no authority for this opinion. (Laporte Tr. 240:22-241:7.) Laporte further opined that the disclosures in the annual report versus the disclosures in the offering statement would be an important factor in the analysis, yet he stated he did not look at these documents and made no effort to compare the disclosures (Laporte Tr. 213:24-214:10, 215:1-5, 233:11-22.)

Laporte observed that disqualification following a permanent suspension would prevent an issuer from raising money in reliance on a Regulation D exemption, which in his view is the

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[10] Obviously, there was no evidence or argument proffered by Laporte or Med-X to support the notion that the provision adopted by the Commission was anything other than valid.

primary way capital is raised. (Laporte Tr. 185:24-187:6.) He testified that if a permanent suspension were issued against Med-X, it could apply for a waiver of the disqualification from Regulation D. Though waivers are not automatically given, Laporte stated that, based upon his experience, if an issuer is deserving, it will receive a waiver. (Laporte Tr. 226:2-227:23.)

III. ARGUMENT

A. The Division Has Established that Med-X Violated Multiple Requirements of Regulation A+

During the hearing in this matter, the Division established that Med-X failed to file its required annual report and sold significant shares of stock when it was prohibited from doing so.[11] The flexibility provided in Regulation A+ to Tier 2 issuers like Med-X was explicitly premised on the Commission's decision to require the filing of timely periodic reports to investors. Med-X's failure to adhere to its reporting obligation, and its unlawful sales of stock, thus undermined one of the most significant investor protections underlying the Regulation A+ regime. Accordingly, the Court should issue an order permanently suspending Med-X from a Regulation A+ exemption.

1. The Commission has Established a Mandatory Annual Report Filing Requirement Under Regulation A+ for Tier 2 Issuers and a Prohibition on Sales if an Issuer is Not Current in the Report Filing Requirements

The Commission's rules clearly spell out the obligations of Tier 2 issuers, and there is no dispute that Med-X failed to comply. Under Rule 257 Med-X was required to file an "annual report on Form 1-K for the fiscal year in which the offering statement became qualified" and that the report was to be "filed within the period specified in Form 1-K." Rule 257(b)(1). Near the

[11] In addition, as discussed below, the Division demonstrated and Respondent's witnesses conceded, that as a result of its failed Regulation A exemption, Med-X violated Section 5 of the 1933 Act numerous times.

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 calendar days after the end of the fiscal year covered by the report." *(Id.* ¶ A (2).) Because its offering was qualified on November 3, 2015, Med-X was required to file its annual report by April 30, 2016. (Gomez Tr. 22:16-22, 28-31, 34:15-25, 35-45:1-15; DIV Exs. 4-5.)

Regulation A+ rules further 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. (Gomez Tr. 31:15-25, 32, 33:1-22, 75: 23-25, 76:1-22.) 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. Here, Med-X did not timely file the required annual report but nonetheless sold a significant volume of stock to investors during a time it was prohibited from doing so.

2. The Regulation A+ Exemption afforded to Tier 2 Issuers Like Med-X Was Explicitly Premised on the Issuers Filing Timely Reports to Provide Investors with Important Information about the Company

Regulation A+ was intended to provide small issuers additional capital raising alternatives to full-blown registration or Regulation D (which generally limits purchasers to accredited or sophisticated investors or requires state qualification and registration). *See* Adopting Release at 239-244. The regime ultimately adopted by the Commission used a tier approach, affording "appropriately tailored protections for investors in each tier." *Id.* at 268.

The Commission expected that Tier 1 offerings would be smaller and conducted by issuers unlikely to seek the creation of a secondary trading market in their securities. *Id.* at 162-63. For a Tier 1 offering, an issuer must comply with the registration and qualification requirements of the states. Tier 2 offerings, however, would be larger, more national in nature, and conducted by issuers more likely to try to foster the creation of a secondary market. Tier 2 offerings do not require state securities law registration and qualification. To allow for small issuers "to take advantage of the larger maximum offering size in Tier 2," *id.* at 268, a Tier 2 offering imposes additional requirements, including the requirement to provide ongoing annual reports and audited financial statements, to provide investors with the necessary information to make investment decisions and facilitate capital formation for smaller companies. (Gomez Tr. 20:5-25, 21:1-17, 24:8-25, 25:1-25, 26:1-3.) [12] In other words, allowing Tier 2 issuers to conduct larger, more national offerings and forego state registration as a means to facilitate capital formation, the Commission specifically imposed ongoing reporting requirements on issuers as a means to provide adequate investor protection.[13] The Commission believed that the increase in costs associated with more extensive disclosure would be offset by the anticipated "benefit of a

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[12] Congress explicitly required issuers to file "audited financial reports with the Commission annually" in order to be eligible for the exemption it was mandating. Exchange Act § 3(b)(2)(F) (amended by Section 401 of the JOBS Act). Congress also provided that the Commission may require issuers to "make available to investors and file with the Commission periodic disclosures" as the Commission determined "necessary in the public interest and for the protection of investors."

[13] *See, e.g.,* Adopting Release at 246 ("The disclosure requirements in the final rules seek to balance the burden of disclosure requirements on issuers and the demand of investors for information by offering issuers a capital raising option with lower compliance costs while still mandating relevant information about the issuer and the securities for the market."); id. at 103 (explaining that "improved MD&A disclosure . . . will provide investors with better visibility into management's perspective on the issuer's financial condition and results of operations.").

potentially higher securities valuation stemming from a reduction in information asymmetry between issuers and investors." Adopting Release at 268.[14]

Med-X sought to raise $15 million through a Regulation A+ offering. At that amount, Med-X had the election of seeking qualification as either a Tier 1 offering (which permits offerings up to $20 million) or a Tier 2 offering (which permits offerings up to $50 million). Med-X chose a Tier 2 offering and thereby avoided having to comply with the registration and qualification requirements of the states in which it sold stock. (DIV Ex. 15.) Having made that election and obtained the benefit of preemption, it was essential for Med-X to comply with the counterbalancing investor protection requirements specifically imposed by the Commission on Tier 2 offerings, including the timely filing of annual reports and audited financial statements. To allow Med-X to avoid the consequence of its admitted failure—whether intentional or not—would potentially chill investor interest in investing in Regulation A+ offerings. If an issuer chooses to take advantage of the benefits of a Tier 2 offering, it must fully and accurately comply with the investor protection requirements that the Commission identified as essential components of the Tier 2 regime. The hearing record is clear that Med-X did not so comply.

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[14] As the Commission explicitly noted, there is "a close relationship between disclosure requirements and liquidity." *See* Adopting Release at 225-26, 245 and n.873. Thus, Tier 2 offerings afford issuers a bridge to access capital from a broader base of investors with an eye to developing secondary market liquidity. Success is in large part dependent on affording investors with "real-time access to the information contained in Regulation A filings." Adopting Release at 68. The requirement to file periodic reports was a critical component of the Commission's decision to adopt the Tier 2 offering framework; it was not only necessary to protect investors, but it would encourage investors to participate in Regulation A+ offerings. *See* Adopting Release at 241 (explaining that investors might not participate in Tier 2 offerings if there are undisclosed risks in the offering process).

3. The Commission Has Made it Clear that a Significant Deviation from the Regulation A+ Rules Should Result in the Loss of an Exemption

In promulgating Regulation A+, the Commission considered what deviations from Regulation A+ would be deemed significant for purposes of Rule 260, a rule that sets forth when a failure to comply with Regulation A+ will not result in the loss of an exemption from the requirements of Section 5.[15] It 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). However, 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.) (Gomez Tr. 105:8-25, 106:1-20; *see also*, Laporte Tr. 229:10-22.)

Among the requirements the Commission specifically deemed to be significant are the requirements of Rule 251(d)(3) governing continuous offerings, including the prohibition on the

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[15] It is not necessary to determine in this proceeding whether Rule 260 applies to this administrative proceeding. The Respondent's expert disputed its applicability here, explaining that the rule was properly addressed to what deviations would be deemed significant for purposes of private liability under Section 12 (making anyone who offers or sells a security in violation of Section 5 liable to the purchaser, who may sue to recover consideration paid for the security). Subpart (c) of Rule 260 states that it does not protect a respondent from a proceeding under Rule 258, the rule under which this administrative proceeding was instituted. Even if Mr. Laporte's construction is correct, certainly it is relevant that even for private actions, the Commission provides that failing to file timely reports as *not* an insignificant deviation from Regulation A, but rather "significant to the offering as a whole." In any event, the point of Laporte's testimony is unclear. Med-X's failure to file an annual report subjects the company to a potential lawsuit by anyone who purchased Med-X stock during the time in which Med-X was delinquent in its reporting obligations because Rule 260 effectively removes the safe harbor of Regulation A, and it certainly manifests the seriousness with which the Commission views that kind of failure to comply with the obligations of the rule.

sale of securities if the issuer is not current in its annual filings at the time of such sale. Rule 260(a)(2); Rule 251(d)(3)(i)(F).[16]

The Commission stated its intent that significant deviations from this requirement would result in the loss of the Regulation A+ exemption. According to the Regulation A+ adopting release:

> [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.

SEC Amendments for Small and Additional Issues Exemptions under the Securities 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.)[17] Most significantly, 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.) Thus, Med-X's significant deviations from Regulation A+'s requirements must result in Med-X's loss of the Regulation A+ exemption.[18]

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[16] There is no place for a materiality analysis given the Commission's filing requirement, strict prohibition on sales if the required filing is not current, and significant deviation determination. The mandatory nature of the filing is not dependent on whether it reports good news, bad news or a continuation of the previous news. Regardless of the nature of the information included in the filing, the Commission specifically required that for investor protection the annual report and audited financial statement be filed on a timely basis.

[17] In the context of the adopting release, the Federal Register published the preamble to the rules, which is a description from the Commission of what had been proposed, a summary of the comments that were received, and the rationale for the Commission adopting the changes to the rules. (Gomez Tr. 23:1-17.)

The Commission 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. If an issuer violates Regulation A rules that are significant—which the violations by Med-X indisputably are—the explicit intent of the Commission is that the violations will result in the issuer losing the exemption. The Commission unquestionably determined and embedded the appropriate balancing of public interest factors in the rules.

4. The Commission Has Defined the Requirements for a Rule 258 Suspension Proceedings

In a proceeding initiated pursuant to Rule 258(a), the Commission may at any time enter an order temporarily suspending a Regulation A+ exemption when 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). Here, the Commission issued a temporary suspension because it had reason to believe that Med-X had failed to file its annual report as required by Rule 257(b)(1). Notice was provided to Med-X consistent with Rule 252(b)(2).

Once a temporary suspension is ordered, Rule 258(d) states that the Commission may, at any time after notice and an opportunity for a hearing, enter an order permanently suspending the

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[18] The Adopting Release further stated:

> 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.) (Emphasis added.)

Regulation A+ exemption "for any reason upon which it could have entered a temporary suspension" under Rule 258(a). Rule 258(d). In this matter, after learning that Med-X had violated Rule 251(d)(3)(i)(F) of Regulation A by making a significant volume of sales in a continuous offering during the period in which it was delinquent in filing its required annual report, Division counsel provided Med-X with notice that the sales were a further basis to impose a permanent suspension. (Gomez Tr.48:16-25, 49-50, 51:1-14,81:3-8, 91:1-5,115:15-19,117:22-25,118:1-7; Joint Prehearing Statement, October 24, 2016, Amendments to the Order Instituting Proceedings, ¶ 11.)

"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.) By its explicit terms, Rule 258(c) provides a binary option—either vacate the temporary suspension or enter an order permanently suspending the exemption. If a permanent suspension order is entered by the Commission, "such order shall remain in effect until vacated by the Commission." Rule 258(d).[19] Rule 258(d) defines the necessary predicate for a permanent suspension order to be issued—a permanent suspension order may be entered "for any reason upon which it could have entered a temporary suspension order" under Rule 258(a).

As established during the hearing, Med-X failed to comply with the requirements of Regulation A, not just due to its failure to file its required annual report in a timely manner pursuant to Rule 257(b)(1), but also because it violated Rule 251(d)(3)(i)(F) by making sales in a

[19] Med-X has argued that a permanent suspension order should not be entered because it would subject Med-X to disqualification pursuant to Rule 262(a)(7). However, a collateral disqualification and related waiver process are independent from a Rule 258 hearing. (Gomez Tr. 52: 20-24, 53:8-24.)

continuous offering at a time when it had failed to make the required filing. By its terms, Regulation A+ provides for the entry of a permanent suspension because Med-X failed to comply with the requirements of the exemption by making sales in a continuous offering at a time when it had failed to comply with the filing requirement.[20] No other showing is required in a Rule 258 proceeding concerning the appropriateness of a permanent suspension.

B. There is Ample Evidence Beyond What Med-X Deems a "Single Late-Filed Report" to Support Permanently Suspending Med-X's Regulation A Exemption

Med-X urges this Court to look beyond the largely undisputed facts—which prove the significant violations discussed above—to weigh additional evidence and consider equitable and policy arguments. The company apparently believes that if the Court were to consider the totality of additional factors, including its intent and overall conduct in the offering, the Court would conclude that permanent suspension of its Regulation A exemption is an excessively harsh result under the circumstances. Med-X is wrong.

As established above, the plain language of the Regulation A rules, coupled with the description of the Commission's intent in the adopting release for the rules, strongly militates in favor of a permanent suspension as the appropriate outcome. Even if the Court were to consider

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[20] It should be noted that the discretionary "may" included in Rule 258(d) relates to the issue of whether the Commission may consider in a permanent suspension hearing a basis for suspension of the exemption that is different than the basis upon which a temporary suspension was granted. Rule 258(d) makes explicit that the Commission may consider such a basis. Here, there is no question concerning the notice provided to the Respondent concerning the violation of Rule 251(d)(3)(i)(F) of Regulation A. *See*, Joint Prehearing Statement, ¶ 11. There also is no question concerning both the Respondent's failure to timely object to the inclusion of the illegal sales in this proceeding and its opportunity to fully address the issue. Given the fact that the SEC did not learn of the illegal sales until *after* the imposition of the temporary suspension order and *after* Med-X made its late filing, there is no doubt about the appropriateness of including this additional basis for a permanent suspension.

other evidence adduced at the hearing or other equitable factors or considerations, doing so weighs even more heavily in favor of a permanent suspension.

1. An Exemption From the Offering Registration Requirements of the Securities Act is a Privilege That Demands Strict Compliance With the Rules

As a preliminary matter, even under Med-X's inaccurate premise that the company is facing permanent suspension for a single late filing of an annual report without any aggravating circumstances,[21] Med-X is wrong about the proper analysis the Court should apply. Med-X primarily urges the Court to rely on case law assessing remedies to be imposed when companies with classes of securities registered under Section 12 of the Exchange Act fail to comply with their Exchange Act Section 13 reporting obligations.[22] Specifically, during the hearing Med-X's paid expert Gerald Laporte opined that Exchange Act Section 12(j) revocation of registration cases were the most helpful authority to guide the Court's analysis, despite that he was not aware of a court relying on such cases in a Rule 258 proceeding.[23] As a result, Med-X urges the Court to apply the analysis from *Gateway Int'l Holdings, Inc.* to determine whether to permanently suspend the company's Regulation A exemption. *In the Matter of Gateway Int'l Holdings, Inc.*, Exchange Act Release No. 34-53907, 2006 WL 1506286 (May 31, 2006). In so

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[21] Laporte clarified that despite being a self-styled "wordsmith"—he should have used "aggravating" in lieu of its antonym "extenuating" in his expert report to describe the additional circumstances that would render a permanent suspension of Med-X's exemption appropriate. (Laporte Tr. 198:16-200:3.)

[22] *See* Respondent's Prehearing Brief at 19-23; RES Ex. I at 6-7; Laporte Tr. 174:5-7 ("So I don't know that the Commission has ever issued a temporary stop order or a permanent stop order for the failure to make a periodic filing").

[23] Laporte's testimony and report focused on delinquent-filer cases that dealt with companies that had registered classes of shares pursuant to Section 12 of the Exchange Act. (Laporte Tr. 169-180; RES Ex. I.) But he later opined that the SEC would not permanently stop either a registered *or* exempted offering unless the company did "something pretty serious." Although he did not state what that might include, he did suggest that even if "the president of the company has been thrown in jail", that "quite possibly, [the issuer] could disclose that. . . then the offering could go forward. . . ." (Laporte Tr. 176:4-24.)

doing, Med-X fails to recognize the differences between relying on the Regulation A exemption from registering an offering, and affirmatively registering a class of securities under Section 12 of the Exchange Act.

Gateway arose from a proceeding under Section 12(j) of the Exchange Act involving an issuer that failed to comply with the reporting requirements of Exchange Act Section 13(a) and its associated rules. *Id.* at *1. The company's reporting obligations arose from its having registered a class of securities pursuant to Section 12(g) of the Exchange Act. *Id.* Having found a reporting violation, the Commission sought to determine whether revocation was appropriate and observed the need to balance "the effect on the investing public, including both current and prospective investors, of the issuer's violations, on the one hand, and the Section 12(j) sanctions, on the other hand." *Id. at *4.* In making this determination under 12(j) of the Exchange Act, the Commission in *Gateway* "consider[ed], among other things, the seriousness of the issuer's violations, the isolated or recurrent nature of the violations, the degree of culpability involved, the extent of the issuer's efforts to remedy its past violations and ensure future compliance, and the credibility of its assurances, if any, against further violations." *Id.* The Commission then applied those factors to the particular circumstances presented by the violation and the potential consequences of revocation to existing and future investors.

Even though the *Gateway* analysis has never been applied to the suspension of an exemption from registration, Med-X urges the Court to do so here. Notably, Laporte conceded at the hearing that he had not read a single Regulation A case—nor, for that matter, any case dealing with the suspension of an exemption—in drafting his report or preparing for his testimony. (Laporte Tr. 220:20-23, 221:9-23, 222:1-22). Nor did Med-X's Prehearing Brief cite a single case relating to any Regulation A or other exemption. (Respondent's Prehearing Brief at

19-23). The dearth of case law consistent with Med-X's proposal makes sense: the *suspension of a privilege* for failing to comply with an exemption under the 1933Act and the *revocation of registration* for failing to comply with the reporting requirements mandated as a result of registering shares under Section 12 of the Exchange Act are, and ought to be, analyzed differently.

Specifically, Med-X's proposed approach ignores that registrations are the default requirement under the 1933 Act,[24] and "the exemption from the registration requirements accorded to offerings qualifying under Regulation A is a *privilege* which *demands that issuers comply strictly with the regulation* from the time of the initial filing." *In re Mutual Employees Trademart, Inc.*, 40 S.E.C. 1092, 1962 WL 68472 at *5 (Apr. 17, 1962) (emphasis added).[25] In *SEC v. Cavanagh*, the Second Circuit observed, "Registration exemptions are construed strictly to promote full disclosure of information for the protection of the investing public." 445 F.3d 105, 115 (2d Cir. 2006). Thus, the Regulation A suspension cases (decided before the recent amendments adding an annual filing requirement for Tier 2 issuers like Med-X) demonstrate clearly that the exemption *is a privilege*, the loss of which does not require either bad faith or persistent or egregious conduct.[26] *See, e.g., In re Robert Mfg. Corp.*, 45 S.E.C. 518, 1974 WL

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[24] As Laporte testified about the registration requirement, "[O]ur Division director used to say it's either got to be registered, exempt, or . . . it's illegal." (Laporte Tr. 198:9-11).

[25] *See also Tabby's Int'l., Inc. v. SEC*, 479 F.2d 1080, 1082-83 (5th Cir. 1973) (affirming SEC's permanent suspension including its finding that "[t]he exemption provided by Regulation A is a conditional one based on strict compliance with express provisions and standards, and its suspension is appropriate where they are not met.")

[26] Indeed, if the exemption is not available to an issuer, an issuer can still: (1) register the offering or (2) take advantage of any other available exemption to conduct an offering.

161431 at *2 (Apr. 30, 1974) (ordering permanent suspension despite good faith of issuer in attempts to cure deficiencies).[27]

In contrast to the loss of a privilege that was used by a company voluntarily, revocation of registration occurs in a very different context. For example, a hearing concerning a suspension of the Regulation A exemption focuses on whether an issuer meets the requirements necessary to warrant continued use of the exemption to offer and sell securities within certain defined constraints. In contrast, a proceeding pursuant to Section 12(j) generally determines whether the issuer *violated* Section 13 and, if so, whether it is appropriate to revoke the registration of a publicly traded security, which entails consequences not presented by a permanent suspension of exemption.[28] *See, e.g., Gateway*, 2006 WL 1506286 at *4-6 (discussing the remedy in a 12(j) case). It is for this reason that the Commission's analysis of the factors in *Gateway* is tailored specifically to the circumstances presented by revocation.[29] Thus,

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[27] In *In re Am. Television & Radio Co.*, 40 S.E.C. 641, 1961 WL 61056 (Apr. 18, 1961), the issuer's Regulation A exemption was suspended when it failed to supply the offering circular to some investors and issued press releases, without filing the releases with the Commission. *Id.* at *6. The Commission was not persuaded by the issuer's contentions that: (1) it cooperated with the Commission in seeking to remedy its violations, (2) the violations of Regulation A were "technical" in nature, (3) it lacked the intent to violate Regulation A, (4) that it sought expert advice in complying with Regulation A, (5) no investors were harmed by the deficiencies in their filings, or (6) the temporary suspension was harmful enough to their business, finances and publicity. *Id.* at *7. The Commission upheld a permanent suspension finding that, regardless of an issuer's sophistication or history, making accurate disclosures under Regulation A is vital "to give prospective investors access to and an opportunity to consider accurate and adequate disclosures of material facts." *Id.* at *8.

[28] For example, under Section 12(j), "no member of a national securities exchange, broker or dealer shall make use of the mails or any means or instrumentalities of interstate commerce to effect any transactions in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked . . . ."

[29] *Gateway*, 2006 WL 1506286 at n.27 ("The standard articulated in the text, while informed by the court's discussion in *Steadman*, reflect the more particular considerations relevant in a proceeding where termination of an issuer's registration is a possible sanction for failures to make required filings.").

there is no question that an issuer that has voluntarily sought to make use of a Securities Act exemption is in a meaningfully different position than an issuer with exchange-traded securities that has been found to have violated Section 13, and faces revocation that will halt trading. Med-X's attempt to conflate the legal authority governing these vastly different regulatory schemes is therefore inapposite.

Second, in its pre-trial brief and at the hearing, Med-X, again without citing any case law, argues that "an analogous provision in Section 8(d) of the Securities Act governing stop orders that are issued when a Securities Act registration statement is not updated to reflect material current information, the stop order is not permanent and ceases to be effective once the registration statement is updated to reflect the information required by the SEC." Respondent's Pretrial Brief at 19 (emphasis omitted). Conflating the analysis of whether to permanently suspend an issuer's Regulation A exemption for what Med-X argues is a "single delayed periodic filing" with lifting a stop order under Section 8(d) ignores both the facts of this case, the language of Section 8(d), and a critical component of Regulation A. *Id.* at 19-20. As discussed above, Med-X's failure to comply with Regulation A was not limited to a "single delayed periodic filing," but instead involved, among other things, a huge volume of sales made at a time Med-X was delinquent in its annual report in direct violation of the exemption. Specifically, as Laporte conceded, Rule 251(d)(3)(i)(F) automatically prohibited Med-X from selling any additional shares of its stock the moment its annual report filing date passed; any sale thereafter was in violation of both Regulation A and Section 5 of the 1933 Act. (Laporte Tr. 209:16-25, 210:1-5.)[30] Thus, by the plain language of Rule 251, there is essentially a Section 8(d)-type stop order built into the rule—*i.e.*, a prohibition on any further stock sales during the period of

[30] As Rule 251 states, Med-X was permitted to sell its stock "only if the [company was] current in its annual and semiannual filings pursuant to Rule 257(b), at the time of such sale."

delinquency. Med-X failed to abide by that prohibition, instead selling a large volume of shares to Med-X investors while it was delinquent in its annual report filing. In filing its annual report, Med-X did not cure its persistent non-compliance. Med-X's situation, therefore, cannot be compared to an issuer that cures a misrepresentation in a registration statement after receiving a stop order.

Beyond this, however, Section 8(d) explicitly states that when the registration statement containing the material misrepresentation or omission is "amended in accordance with [the] stop order" issued by the Commission, the Commission "*shall* so declare and thereupon the stop order *shall* cease to be effective." (Emphasis added.) Regulation A, however, committed to the Commission's discretion whether to impose a permanent suspension or vacate the temporary suspension. *See* Rule 258(d) ("The Commission *may*. . . enter an order permanently suspending. . .") (emphasis added). Here, not only did Med-X not "cure" its violations of Section 5 and its noncompliance with the clear language of Regulation A's prohibition on sales while delinquent in annual report obligations, but even if it had, there is nothing that would compel lifting the temporary suspension in a way similar to Section 8(d)'s mandatory lifting of a stop order.

2. Even Viewed in Light of the *Gateway* Analysis Permanent Suspension is Still the Only Appropriate Remedy

Notwithstanding that the *Gateway* analysis does not govern whether to permanently suspend Med-X's Regulation A exemption, were the Court to consider the factors Med-X proposes, the company's prospects do not improve. In its Prehearing Brief, Med-X, citing *Gateway*, urges the Court to "consider, among other things, (1) the seriousness of the issuer's violations; (2) the isolated or recurrent nature of the violations; (3) the degree of culpability involved; (4) the extent of the issuer's efforts to remedy its past violations and ensure future

compliance; and (5) the credibility of the issuer's assurances against future violations." Respondent's Prehearing Brief at 20 (citation omitted).

Turning to the first *Gateway* factor, the "seriousness" of Med-X's violations, as the Division established during the hearing, Med-X's view that it simply missed a filing deadline without any "aggravating circumstances"[31] could not be less accurate. As discussed above, the premise of Laporte's opinion and Med-X's overarching theory—*i.e.*, that without ["*sufficiently*"] aggravating circumstances permanent suspension would be antithetical to the purpose of the JOBS Act or custom and practice of the SEC—fell apart in the face of the overwhelming aggravating circumstances, primarily in the form of numerous and persistent (and admitted) violations of Regulation A and Section 5.

A closer look at Med-X's actions and omissions demonstrates that Med-X would fare no better under the remaining *Gateway* factors. The company's violations were not isolated, but were recurrent. And even after receiving actual notice of their failure to comply with the Regulation A exemption, Med-X continued selling shares of stock without complying with Regulation A and in violation of Section 5. Moreover, Med-X did not actually remedy its violations by filing its report, as doing so did not remedy the large volume of unlawful sales made during the period of delinquency. Finally, Med-X's president demonstrated his indifference to investors' rights to receive essential information about the company, and his general lack of candor apparent at the hearing and summarized above, render any "assurances against future violations" simply not credible.

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[31] During his cross-examination, Laporte changed his opinion and sought to amend his report stating, "If I were to issue this opinion today, I would say sufficiently aggravating circumstances." (Laporte Tr. 212:17-24.)

3. Med-X's Conduct—After Learning its Annual Report Was Late—Underscores the Need for a Permanent Suspension

Throughout the proceedings Med-X has maintained that it would be inequitable to permanently suspend the company for what it asserts is a single periodic late-filing, which it corrected, and which Med-X apparently believes resulted in no adverse consequences worth addressing at any length. Indeed, Med-X's paid expert based his report and his testimony on his putative understanding that at issue in this proceeding is no more than a single late-filed report without any "extenuating [read: "aggravating"] circumstances."[32] Med-X is mistaken on the facts, the law and the equities.

Med-X has consistently glossed over the critical fact that more than a quarter of all the Med-X stock sold during the offering was in violation of Rule 251 of Regulation A and Section 5 of the 1933 Act. Med-X contends that the company's failure to timely file its annual report resulted from an innocent misunderstanding of the filing requirement and that any unlawful stock sales that occurred during the period the report was late were unintentional. However, as discussed below, Med-X continued to sell stock *after* learning that its annual report was late and those sales establish additional grounds for a permanent suspension of the exemption.

a. Med-X Continued Selling its Stock *After* Learning its Report Had Not Been Timely Filed

Med-X continued to offer and sell its securities ***after*** being notified that its annual report was delinquent. Specifically, Med-X continued to sell shares of its stock through September 27, 2016, ultimately selling a total of approximately $873,000. (DIV Exs. 15, 16 A-C; 17.) On August 30, 2016, the SEC's Division of Corporation Finance sent Med-X's CEO a letter

[32] During Laporte's cross-examination, he conceded that he was asked to assume that "the only violation was that the report was late and corrected" and that he was not asked to assume that Med-X had engaged in violations of Section 5. (Laporte Tr. 218:10-14, 219:6-11; *see also*, RES Ex. I at 2-3; Laporte Tr. 214:4-8.) These concessions, among others, render his opinions of little value to determining the proper result here.

advising the company that it was "not in compliance with the requirement of Tier 2 of Regulation A to file an annual report". . . and noting that "[a]n annual report was due April 30, 2016, 120 days from the end of [Med-X's] fiscal year." (DIV Ex. 7.) The letter further admonished that the SEC could enter an order temporarily suspending Med-X's Regulation A exemption "without further notice." Med-X's CFO, Ronald Tchorzewski received the letter no later than the morning of September 2, 2016, and he forwarded it to Mark Richardson, Med-X's corporate counsel—who is also a principal shareholder and former director of the company. (RES Ex. G-1.) According to Richardson, the letter set off an urgent response within Med-X, during which he and others in the company "worked night and day for two weeks" to get the annual report (and the semi-annual report) drafted and filed as soon as possible.[33] (Richardson Tr. 258:21-23.) Med-X filed the late report after close of business on September 19, 2016, and it was date stamped the following day. *Id.*

From the date Med-X received the letter advising the company that it was out of compliance with its Regulation A reporting obligations, until it stopped selling shares *days after* the SEC entered the temporary suspension order, the company sold thousands of dollars worth of stock.[34] This means that, notwithstanding the express language of Rule 251—which prohibits sales of stock when an issuer is not current in its periodic reporting requirements—Med-X continued selling its stock despite having actual knowledge that it was not in compliance with

[33] Med-X CFO Tchorzewski's email to Richardson on September 2, 2016, demonstrates that Med-X officers immediately understood the significance of the letter from the SEC. (RES Ex. G-1). Tchorzewski wrote to Richardson as follows: "Attached is a letter received today. Please review and call us ASAP!" *Id.* (emphasis in original); *see also*, (Mills Tr: 292-293 (discussing actions Med-X took, and the significance of its late filing)).

[34] The amount of the sales may be calculated by counting the number of sales observations and summing up the "Amount" and "Shares" as reported in rows 722 (or 730 if sales on September 2, 2016 are not counted) through 754 of DIV Ex. 15. According to Med-X's data, the last shares were sold or settled on September 27, 2016, 11 days after the SEC entered the temporary suspension order.

Regulation A, and that it could—at any moment, and without additional notice—have its exemption suspended. Moreover, as Financial Economist Christopher Reilly testified—and as Division Exhibits 15-17 demonstrate—these sales continued until September 27, 2016 (more than 10 days after the Commission's September 16, 2016 order temporarily suspending Med-X's Regulation A exemption). (Reilly Tr. 147:5-13, 148:2-9; DIV Ex. 15, Rows 747-754.)[35]

In light of these significant, persistent and distinct violations of Regulation A, Med-X simply cannot sustain the fiction that its original failure to timely file the annual report in April 2016 was an "inadvertent" one-off mistake that occurred in the context of its "extremely diligent and cautious" pattern of "t[aking] the extra time to do the project properly." (Richardson, Tr. 257:2-13.) Med-X *continued* to violate the Regulation A requirements *after* its error was explicitly brought to its attention. Even standing alone, this deviation from Regulation A's requirements provides an adequate basis to support a permanent suspension of the exemption.[36] As discussed below, Med-X also demonstrated its indifference to its disclosure obligations in other ways.

b. Med-X Failed to Disclose that the SEC had Temporarily Suspended its Regulation A Exemption When it Filed its Overdue Annual Report

Med-X's endeavor to focus this Court on the contents of its annual report in order to depict its violations as technical is legally and factually doomed. First, as noted, *supra* at n. 16,

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[35] Laporte agreed that from April 30 through September 27, 2016, Med-X "engaged in numerous violations of Section 5." (Laporte Tr. 210:1-5.)

[36] *See* Rule 258(d) of "Regulation A-Conditional Small Issues Exemption" 17 C.F.R. § 230.258 (d).

the rules do not include materiality as an element of determining whether Med-X's report was delinquent or whether the sales of stock during this period were illegal. Second, Med-X did not make any effort to warn investors about new risks arising from its failure to fulfill the relevant regulatory requirements. This failure further underscores Med-X's lack of commitment to being fully transparent to its investors.

Specifically, the report contains a section entitled "Statements Regarding Forward-Looking Information," which includes both estimates about the company's performance as well as "[f]actors which could have a material adverse effect on [Med-X's] operations and future prospects." (DIV Ex. 11 at DIV0248.) Immediately below this heading, the annual report lists in bullet point format more than two dozen broadly worded categories of potential risk factors. *Id.* Med-X chose to omit from this list of identified risks the fact that: (1) the company had failed to timely file its annual report, which was due April 30, 2016; (2) the SEC had entered a temporary suspension order (after warning Med-X in writing that its failure to timely file its annual report could lead—at any time, and "without further notice"—to a temporary suspension); and, (3) the suspension order could result in a permanent suspension of the exemption. (DIV Ex. 7.)[37]

[37] Three days before Med-X filed its report, the SEC publically announced the temporary suspension of Med-X's Regulation A exemption and published both a press release and the suspension order on the internet. On September 16, 2016, the press release and temporary suspension order were published online at https://www.sec.gov/litigation/admin/2016/33-10216-s.pdf; and, https://www.sec.gov/litigation/admin/2016/33-10216.pdf. Other publications reported on the suspension soon after it was made available online. *See, e.g.,* http://www.lexology.com/library/detail.aspx?g=3cc36051-1d7c-410d-917c-e4967f962562; http://www.jdsupra.com/legalnews/sec-suspends-regulation-a-offering-10979/. Notably, in its Prehearing Brief, at p. 13, Med-X stated that "on September 19, 2016, by cover letter dated September 16, 2016, Med-X received an 'Order Temporarily Suspending Exemption Pursuant to Section 3(b) of the Securities Act of 1933 and Regulation A Thereunder, Statement of Reasons for Entry of Order, and Notice of And Opportunity for Hearing."

This contrasts sharply with information that Med-X *did* include in its late-filed report which touted its "Agreement with Monarch Bay Securities, LLC" in a manner that suggested continued benefits from the Regulation A+ offering:

> On September 14, 2016, the Company entered into an agreement . . . with Monarch Bay Securities, LLC . . . pursuant to which Monarch has agreed to act as an exclusive Financial Advisor to Med-X for a 'best efforts' offering of securities planned by Med-X to raise capital in accordance with the exemption from registration available under Regulation A+ (Tier 2) of the Securities Act of 1933.

(DIV Ex. 11, DIV0257.) The omission of significant information from Med-X's late-filed annual report undercuts their claims that it would be in the public interest to vacate the Regulation A suspension order. Even when faced with a temporary suspension, Med-X failed to provide investors with key information that could impact the company's future performance.[38]

c. Mills' Testimony Demonstrated a Lack of Candor and Indifference Towards Investors' Rights to Disclosure

Mills, Med-X's founder and president, has personally run afoul of securities laws, as evidenced by the finding of a willful violation of Pennsylvania law, and a related action by the State of California. (DIV Exs. 22-23.) When asked about the circumstances surrounding his violations, Mills gave plainly inconsistent testimony. The Division's attorney asked Mills, "You said someone in 2011 cold called an investor. Who was that someone?" Mills responded without reservation or qualification, "It was at the time my brother-in-law."[39] (Mills Tr. 315:18-20.) Then, when asked, "Your brother-in-law called an investor. Correct?" Mills responded, "We believe so." (Mills Tr. 316:11-13.)

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[38] As Mills conceded at the hearing, the ongoing suspension proceedings are in fact "hurting our financial position because we cannot raise capital right now." (Mills Tr. 295:12-14.)

[39] When the Court asked him what incentive his brother-in-law would have to cold call people to sell the stock in Pacific Shore Holdings, Mills replied, "He was working in business development with me in the company. . . ." (Mills Tr. 325:20-25.)

However, upon being confronted with the specific findings outlined in DIV Ex. 22, Mills reversed himself, testifying, "I still believe that this is speculative. I don't think that this actually even happened." (Mills Tr. 323:1-3.) When challenged to explain, Mills became defensive and attempted to explain:

- "I see that it says findings of fact, but I still, to this day, do not believe that this is fact. I believe that this is—first, I would never cold call anyone. Okay? That's the first thing." (Mills Tr. 323:7-10.)
- "We didn't know who it was. Quite frankly, it could have been anybody." (Mills Tr. 323:7-15.)
- "Maybe somebody at our company made [a cold call] and I was not aware of it, but it was not me and I did not condone it." (Mills Tr. 324:20-22.)
- "We came into the law, and I still, to this day again, if somebody made a cold call. I don't know. I can't verify whether they did or didn't." (Mills Tr. 325:12-14.)
- When the Division's attorney asked Mills, "You don't know if somebody did or didn't [cold call investors], but if somebody did, you think it was your brother-in-law; is that correct? He responded, "Only because he was named in the next document [DIV Ex. 23]." (Mills Tr. 325:15-19.)
- Mills later suggested the state violations may have had their genesis in a former or current employee who engaged in an act of sabotage, explaining, "Again, you know, we've had some people working for the company that have done some, you know, things that are unethical, and, you know, trying to get people in trouble is something that happens a lot when you run a company and you have a lot of employees. People do some strange things." (Mills Tr. 326:2-7.)[40]

Mills' inconsistent testimony regarding his securities violations was not the only instance he demonstrated a lack of candor. Indeed, after testifying that Med-X had raised "just under" $1.2 million under the company's prior offering, Mills admitted that he misrepresented that figure when speaking at conference for investors in the cannabis industry. During the

[40] The colloquy continued with Mills further casting about for a credible explanation upon which to rest. Ultimately, he testified the he fired his brother-in-law, not because he did not believe his former employee's denial regarding cold calling investors, but because, Mills "couldn't have somebody working for the company that was named in a document that said he was cold calling" ignoring completely that he himself was named in the documents at issue. (Mills Tr. 333:1-2.)

conference, Mills told his audience, "We raised about $1.5 million on the 506(c) in the last 12 months from Med-X." (DIV Ex. 19, 9:05mn.) When he was later asked how much the company raised during that offering, Mills sought to gloss over his dishonesty as follows: "First, in its 506(c), it brought in, like I said before, 1.1, 1.2, and let's just say—let's round it up like I did rounding it up in my, you know, statement during that conference of $1.5 million." Mills' "rounding up" at best reflects his indifference to providing accurate information when specifically asked.

Mills also expressed indifference during the hearing towards the importance of the periodic annual report—testifying that even if Med-X had filed its report on time, it would not have made any difference to investors. Mills initially testified that he thought it was "important" and a "serious problem" for Med-X to miss its filing deadline, noting that the concerns were even greater "for a company like [Med-X] . . . due to the "industry that [Med-X is] in." (Mills Tr. 293:12-20.) He also nominally "accept[ed] responsibility" "for the seriousness of the violation" and "the fact that shares were sold during the period . . . that there was a late filing." (Mills Tr. 294:13-19).

However, during cross-examination Mills adopted a much less conciliatory position, testifying expressly that it would not have mattered to investors whether Med-X filed its annual report on time. Mills' testimony during cross-examination provides a window into his views on the importance of disclosure to potential investors. He testified that although the annual report contained "important information" in his view, investors "wouldn't be looking at the periodic filings to make a—to focus on investing. They would look at the offering circular." (Mills Tr. 309:17-23.)

He was then asked, "So, is it your position that if you had filed the annual report on time, it wouldn't have made any difference to the investors?" He responded, "If the annual report was on time, I don't think it would have made any difference to the investors." (Mills, Tr. 310:4-9.) The colloquy continued:

> Q: So the 150 investors who invested in Med-X after April 30th, when the report was due but not filed, you don't think that it matters to the investors that you failed to file that report?
>
> A: I think it matters to the investors that we missed a filing date, but when we look at the report now, they can see that there's been growth in the company and they can see that we've done some stuff that's beneficial to the investors.

(*Id.* at Tr. 310:10-18.)

As discussed above, the SEC deems a timely and accurate annual report to be essential, and its significance is not determined *post hoc* on a case-by-case basis.[41] Still, it is worth noting that Mills' testimony—albeit suffused with nods to the "importance" of the information—demonstrates a lack of concern for the investors and their rights to full disclosure. And even a cursory review of the late-filed report proves Mills' testimony about "growth in the company" and "stuff that's beneficial to the investors" is spurious.[42]

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[41] Laporte's testimony on this point betrayed an apparent lack of awareness of the significance of annual reports. He appeared to believe that the requirement in the rules for annual reports "are not nearly even designed for these people who are purchasing", adding, "I don't think there's any requirement that you give them to offerees." (Laporte Tr. 214:12-13, 19-20.) He concluded, "So I'm not sure that there was any harm that was necessarily done by selling to these people." (*Id.* at 214:21-22.) Despite that he had not "compared the information that was in the offering statement to the information that was in the annual report," Laporte nonetheless concluded "I'm not sure the mix of information that [the investors] would have gotten would have been any different even if the report had been filed." (Laporte Tr. 214:22-25, 215:1-5.)

[42] Med-X's performance in fiscal year 2015 was poor. For instance, for the period from January 1, 2015, through December 31, 2015, Med-X reported meager revenue of $200 and a loss of $402,227. (DIV Ex. 11, DIV0274). This was far worse than the company fared the year previous, when its revenue was $360 and its loss was a much less daunting $16,135. (*Id.*) It is therefore

And, even under the analysis that Med-X would have the Court apply to its case, Mills' indifference—not to mention his company's paid expert—towards investors' rights to current and accurate disclosure about the company counsels against finding that Med-X would "ensure future compliance" with its Regulation A obligations. *See* Respondent's Prehearing Brief at 20 (citation omitted).

In sum, examining the totality of Med-X's actions and omissions surrounding the Regulation A exemption worsens, rather than improves, the company's position. The evidence adduced at the hearing underscores the need to protect the investing public by "making the safeguards of a registration statement under the Securities Act a prerequisite for any further public offering of securities" by Med-X because of the company's "failure to adhere to the conditions of the exemption." *Tabby's Int'l*, 479 F.2d at 1082-83 (emphasis added).

C. The Involvement of Counsel in Med-X's Failures Provides No Defense

During the hearing, Med-X presented the testimony of Richardson, who sought to take responsibility for what Med-X deems a "single late filing." It is unclear if, through Richardson's admission to having erred, Med-X seeks to mount a complete defense for missing the filing deadline or whether it hopes only for some mitigation of the result. It does not matter, however, because, as demonstrated above, Med-X's violations extend far beyond Richardson's ostensible inadvertence or mistake relating to the date Med-X was required to file its annual report. Moreover, even if Richardson's error might have partially explained Med-X's violations, acts or

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difficult to understand how this represents "growth in the company" and "stuff that's beneficial to the investors." The late-filed annual report also further highlighted the interconnected relationship Med-X enjoys with PSH. For instance, in the "Related Party Transactions" section the report disclosed that in 2015 Med-X reimbursed PSH $14,376 for expenses paid on the Med-X's behalf. And it also indicated that on April 14, 2015, Med-X lent PSH $40,000 as a short-term, interest free loan for 60 days. (DIV Ex. 11, DIV0274).

omissions of its attorney are not relevant in determining whether to suspend its Regulation A exemption.

1. Scienter Is Not an Element of a Regulation A Violation, and Reliance on Advice of Counsel Is Thus Legally Insufficient

As an initial matter, scienter is not an element of a Regulation A+ violation, and evidence relating to Med-X's intent or state of mind is thus irrelevant. The reason is that Section 5 imposes strict liability on sellers of securities in unregistered transactions. To prove a violation of Section 5, a plaintiff need not establish scienter.[43] 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.[44] Thus, if a defendant's scienter is not relevant, as is the case here, then evidence of a defendant's purported reliance on counsel is not a permissible defense. This is well-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 (Commission Opinion Oct. 23, 2009, *aff'd*, 398 F. App'x 603 (D.C. Cir. 2010) (*per curium*).[45]

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[43] *SEC* v. *Phan,* 500 F.3d 895, 902 (9th Cir. 2007); SEC v. *M&A West Inc.,* No. C-01-3376 VRW, 2005 WL 1514101 at **8-9 (N.D. Cal. Jun. 20, 2005). *See also 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, *3 (S.D. Fla. Feb. 22, 2002).

[44] *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.)

[45] 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); *SEC v. Novus Technologies, LLC,* No. 2:07-CV-235-TC, 2010 WL

2. Reliance on Counsel Does Not Mitigate the Available Remedy

In addition to providing no legal defense, a claim of reliance on counsel also provides no basis to mitigate the remedy that should result because of Med-X's failure to comply with the requirements of Regulation A+. As demonstrated above, the Commission's unambiguous intent in promulgating Regulation A+ was that significant deviations from the rules' requirements, such as those committed by Med-X, should result in a loss of the exemption.

Med-X asserts that it is less culpable for its violations of Regulation A+ and does not warrant a permanent suspension because its violations resulted from the inadvertent error of its counsel. However, the Commission was aware that hardship could befall issuers for inadvertent errors. In striking the balance between protecting investors and avoiding hardship to issuers, the Commission determined that only insignificant deviations could, in limited circumstances, avoid loss of the exemption.

Even if a significant deviation is inadvertent the Commission has determined that the need to protect investors outweighs any hardship to the issuer. The language of the rules and the accompanying commentary reflect the Commission's intent militating conclusively against

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4180550 at *12 (D. Utah Oct. 20, 2010). 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. 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.* The district court previously 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). In *Swenson v. Engelstad*, 626 F.2d 421, 424 (1980), the Fifth Circuit emphasized that 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." (Emphasis added.)

allowing a significant deviation to avoid a permanent suspension. The Commission's intent and determination in this regard was fully considered, measured and reasonable.[46]

Finally, the Court permitted Med-X to present evidence at the hearing to support its claim that its failure to comply with the requirements of Regulation A resulted from its reliance on legal advice received from its attorney, Mark Richardson. Med-X failed to establish any of the elements of a reliance on advice of counsel claim. While Med-X did delegate to Richardson the responsibility to take care of the Regulation A filings, that delegation is conclusive proof of his full agency relationship, as well as proof that he was acting within the scope of that delegated authority. The delegation does not establish that any legal advice was requested, given, received or relied on.[47]

3. Mistake of Counsel Does Not Mitigate the Remedy Because the Conduct by Counsel Was the Conduct of Med-X

A mistake by counsel provides Med-X with no basis to avoid a permanent suspension. As long established, a person voluntarily chooses its attorney as his representative and agent, 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.

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[46] It also is consistent with earlier Commission precedent. *See, e.g., In re Robert Mfg.* 1974 WL 161431 at *2 (Commission upheld permanent suspension, despite issuer's good faith, because the "concern here is not with the purity of the issuer's motives but with the accuracy of its filing." *See also, Tabby's Int'l.*,479 F.2d at 1082-83 (affirming SEC's permanent suspension including its finding that "[t]he exemption provided by Regulation A is a conditional one based on strict compliance with express provisions and standards, and its suspension is appropriate where they are not met.")

[47] In response to the Court's December 2, 2016 order requiring the production of all documents related to an advice of counsel defense, Med-X produced no documents which support an advice of counsel defense. (*See* RES Ex. G, G-1, G-2.)

626, 633-34 (1962), quoting *Smith v. Ayer,* 101 U.S. 320, 326 (1879). As the Supreme Court in *Link* 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*....this 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. (Emphasis added.)

As Med-X's chosen lawyer-agent, Richardson's actions are deemed to be the actions of the company. Far from absolving Med-X of the consequences of Richardson's admitted mistake, Med-X is responsible for Richardson's actions on its behalf. This is the straightforward and required application of longstanding and clear agency legal principles.[48]

The application of longstanding agency law is pointedly appropriate here due to the relationship between Med-X and Richardson, which relationship is established by, among other things, the following:

- Richardson was one of the Founders of Med-X. (Richardson Tr. 274: 23-25; DIV Ex. 1: Div0055.) Richardson has been attached to and a part of Med-X since the beginning of Med-X. (Richardson Tr. 274: 5-8, 20-22.) As of December 31, 2014, Richardson was a director of Med-X. (DIV Ex. 1: DIV0055, Div0078 – NOTE 6 – Related party Transactions; Div0096, Cf. Div0055; Richardson Tr. 274: 12-19.) Richardson interchangeably has been identified as the General Counsel of Med-X and as Special Counsel. (DIV Ex. 1, DIV0055, DIV0143.)

- Richardson prepared the Med-X Articles of Incorporation. (Richardson Tr. 274: 9-11.) Richardson was involved in preparing the companies transactional and corporate securities work, including writing the Regulation A offering. (*Id.,* 246: 8-10, 249: 6-16, 273:11-13.)

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[48] There is no basis to impose different remedies for a Regulation A violation depending on the job category of the individuals(s) that caused the significant deviation, whether it is a director, officer, inside employee or outside agent.

- Consistent with his involvement as one of the Founders of Med-X, during his time working for Med-X, Richardson did not bill the company for his time. (*Id.*, 276:18-25, 177:1-2.) Richardson did his work for no charge for "the purpose of capitalizing the company....Meaning the work that we did was securities work to enable the company to do the offering so that it capitalized its business plan." (*Id.*, 277:1-17.)

- Richardson received 5 million Founder's shares in Med-X without paying anything. He subsequently received stock options from Med-X. (DIV Ex. 1, Div0055, DIV0078; Tr. 275: 1-23.) Richardson is one of the top four Principal Shareholders of Med-X. (*Id.*, DIV0054-55; Tr. 277:3-8.) Richardson owned 5.48% of Med-X's shares prior to the offering at issue in this matter. Richardson owns more shares of Med-X than Dr. David Toomey, the CEO of Med-X. (*Id.*, DIV0055.)

- Richardson has been and is one of the Principal Shareholders that own voting control of Med-X. The officers, directors, founders and principal shareholders of Med-X, which includes Richardson, were reported to own 98% of the total issued and outstanding capital stock of the company. (DIV Ex. 1: DIV0019; Tr. 277: 21-2, 278:1-7.)

- In addition to representing Med-X, Richardson has provided legal representation to Med-X affiliates Pacific Shores and Matthew Mills concerning Pennsylvania and California securities regulation proceedings. (Mills Tr. 316:21-24, 321:10-18; DIV Ex. 22: SEC-FINRA-E- 01207; DIV Ex. 23: SEC-FINRA-E- 01208.)

As Richardson admitted, it was Med-X's responsibility to comply with the requirements of Regulation A. (Richardson Tr. 271:15-18.) As also admitted by Richardson, his own actions while working for Med-X were the company's actions because he was an agent of the company. (Richardson Tr. 271: 19-23.)

Issuers have the responsibility to either register their securities offerings pursuant to the 1933 Act or be aware of and comply with the requirements necessary to establish and maintain an exemption from the registration requirements. (Gomez Tr. 18:12-4, 101:4-6.) 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 rules.[49] 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 an agent that it chose, embraced and rewarded.

The error Med-X focuses on was the result of its attorney's failure while he was working on the Med-X offering under the Regulation A rules, and he was thus required to be aware of when the annual report was required to be filed. Due to Richardson's error, he formed an incorrect assumption about the due date. The late filing and the resulting illegal sales resulted from the attorney's incorrect assumption. The triggering event for calculating the correct due date was the fiscal year in which the offering statement became qualified, as is plainly set forth in Rule 257(b)(1).

Richardson looked at the Regulation A Rules when they were promulgated, but did not do so again until he received the August 30, 2016 letter from the SEC. (Richardson Tr.163: 21-25, 264:1-7, 267-68.) Upon receiving the letter from the SEC notifying Med-X of its failure to file, Richardson read the applicable Regulation A rules and realized that he had made an error.

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[49] Presumably, Med-X could have learned this by reading the few pages of rules that comprise the very regulations pursuant to which it was raising capital. In fact, Mills studied the JOBS Act and claimed to understand the applicable rules and regulations. (Mills Tr. 286:17-25, 287:1-2.) Mills publicly held himself out as an authority on Regulation A+. (*See generally*, DIV Ex. 19.)

Richardson primarily worked with the Chief Financial Officer, Ronald J. Tchorzewski, especially concerning Regulation A. (Richardson Tr. 278: 323-25, 279:1-8.) Tchorzewski is experienced in providing capital raising advice with 35 years of experience in financial accounting and reporting. (DIV Ex. 1, DIV0046.) Among other things, he kept track of Regulation A sales. (*Id.*) Tchorzewski was conspicuously absent from the Med-X line-up of witnesses, although he still is an officer of Med-X.

At that time, he specifically reviewed Rule 257(b)(1) and immediately realized that the annual report had been due April 30, 2016. (Richardson Tr. 256:11-19, 261:21-25, 262-268; DIV Ex. 7.) Not only had Richardson failed to read the clear language of Rule 257(b)(1) on a timely basis, but his error was reinforced by his failure to read Form 1-K, which is specifically referenced in Rule 257(b)(1) concerning the filing of the annual reports. (Richardson Tr. 263: 5-25, 264-265, 266:1.)

Further, Richardson believed that post-qualification amendments filed after the Notice of Qualification of the Offering Statement changed the date that an annual report was due to be filed. (Richardson Tr. 257:14-20.) However, Rule 257 requires that the annual report must be filed for the fiscal year in which the offering statement became qualified. Post-qualification of an amendment simply qualifies the amendment, it does not change the qualification date of the original Offering Statement (Gomez Tr: 42:6-19, 44:15-25; Rule 257(b)(1).) If post-qualification amendments to the offering could change the deadline for filing annual reports that could result in an annual report never being filed—the issuer could perpetually avoid the due date of the annual report by filing post-qualification amendments each year. (Gomez Tr. 43:12-23.) Such illogic would effectively and nonsensically eliminate the annual report requirement which was mandated by Congress in the JOBS Act. (Gomez Tr. 44:2-6.)

IV. CONCLUSION

Permanent suspension is the only appropriate result here. There has never been any dispute that Med-X violated the plain language of Regulation A by failing to timely file its annual report. Nor has there been any dispute that Med-X sold almost one-third of the total shares in its offering to investors who were deprived of the important information contained in annual reports generally. Med-X seeks to avoid a permanent suspension by maintaining the

façade that its attorney made a single error, and that—particularly in light of the (inapposite) case law it cites—the company otherwise merits retaining the privilege of a Regulation A exemption. Med-X has invited the Court to consider equitable and other factors, including the contents of its annual report. Accepting Med-X's invitation only makes matters worse for the company, as delving further into the evidence demonstrates that the public should be protected by permanently suspending Med-X's exemption from the registration requirements in the 1933 Act.

March 21, 2017

Respectfully submitted,

Kevin P. O'Rourke (202) 551-4442
Joshua E. Braunstein (202) 551-8470
Nancy L. Singer (202) 551-4750
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 a true copy of the Division of Enforcement's Post-Hearing Memorandum was served on the following on this 21st day of March, 2017, in the manner indicated below:

By Electronic Mail:

The Honorable Jason S. Patil
Administrative Law Judge
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549
alj@sec.gov

James F. Moyle, Esq.
MOYLE LLC
875 Third Avenue, 28th Floor
New York, NY 10022
Telephone: (646) 756-4608
Facsimile: (646)756-4587
James.Moyle@JFMoyle.com

Kevin P. O'Rourke