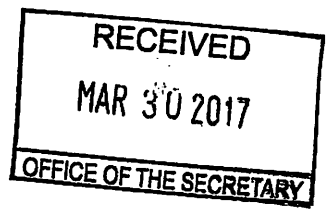
HARD COPY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-17551

In the Matter of

MED-X, Inc.,

Respondent.

RESPONDENT'S POST-HEARING BRIEF

James F. Moyle
MOYLE LLC
875 Third Avenue, 28th Fl.
New York, NY 10022
(646) 756-4608
James.Moyle@JFMoyle.com

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

Rules and Regulations

Other Authorities

Hearing Exhibits

Pursuant to the Post-Hearing Orders dated January 27, 2017 and March 16, 2017, Respondent Med-X, Inc. ("Respondent"), through its undersigned counsel, submits its Post-Hearing Brief.

Preliminary Statement

In an unprecedented case, the Commission is seeking to *permanently* bar one of the first few issuers under the new Regulation A+ from completing the majority of its offering and from ever again having access to that exemption. The Commission requests this draconian penalty because Respondent Med-X, a micro-sized company with eight employees, (i) unknowingly failed to timely file an annual report required under the new rules, and (ii) during the period its report was unknowingly delinquent, continued selling shares pursuant to the qualified offering.

But the permanent bar demanded by the Commission is not required under the rules nor is it equitable under the facts of this case. This Court has the power, as have others before it, to deny a permanent suspension and vacate the temporary suspension in light of ameliorating factors that are widely used in cases where important filings are missed.

This entire proceeding is governed by Rule 258, which provides that the "The Commission ***may,*** at any time after notice of and opportunity for hearing, enter an order permanently suspending the exemption" for any violations of the Rules. Thus, a permanent suspension is an elective remedy – one that the Commission may seek to impose or forgo. And there is no doubt that this Court has the power to determine whether a permanent suspension or vacating a lengthy temporary suspension is the

appropriate remedy under the facts and circumstances developed at the hearing in this matter. Gerald Laporte, an SEC insider who helped draft Regulation A+ and the only expert to testify in this matter, opined that this Court has such discretion under Rule 258 That opinion was echoed by the Division of Enforcement's primary witness, Sebastian Gomez Abero.

Tellingly, in cases brought by the Commission when companies have missed filing deadlines, it is exceedingly rare to be suspended from selling securities based solely on the missed filing. To prevent manifest injustice for a filing error – despite the seriousness of such an offense, the Commission and courts have developed a series of factors – the "*Gateway* factors" – to balance the need for a suspension or revocation of registration against the harm that such a punitive remedy could have on a company and its investors. While this case presents a matter of first impression with respect to the application of the *Gateway* factors to Regulation A+ filings, to avoid the same injustice those factors are appropriately applied here.

And historically, the Commission *has* considered facts and circumstances nearly identical to those in *Gateway* when deciding whether to suspend an exemption under "old" Regulation A, which in various permutations *required* the filing of semi-annual stock sales reports. To prevent manifest injustice, the Commission weighed the facts and circumstances surrounding the violation against the harm that such a punitive penalty would have on the company and its investors. When appropriate, suspensions imposed for the late filings were vacated. The application of these *Gateway*-type factors here is equally important.

Uncontroverted evidence – and a failure of proof by the Commission -- demonstrates that the facts and circumstances here weigh heavily against imposing a penalty that would significantly limit Respondent's access to capital and, as the company's President testified, run the risk of "shutting it down." For example:

- Although any failure to file is concerning, there is no evidence that investors were harmed in any way by the failure to timely file. Indeed, the critical offering document, the company's third amended Offering Statement, was "re-qualified" by the Commission in late January 2016, just three months before the missed annual report was due. The Commission adduced no evidence that investors were harmed in any way, or penned even a single complaint, about their investments in light of the delayed report.
- The fact that the required report is important and may be helpful to some investors does not, standing alone, undercut application of the mitigating factors applied in historic Regulation A periodic filing cases, or more recently in *Gateway* or *Steadman*.
- The late report (and the not-surprising sale of shares during the period when the Company was unaware of the delinquency) was an isolated violation for Med-X. The record shows the Company was careful to file a detailed, thorough Offering Statement that garnered only one comment from the Commission before being qualified, and followed that with multiple amendments to be sure the Company was fully complying with

any requirement to disclose new and material information about the offering.

- The failure to file was an inadvertent error by the Company's outside counsel, who admittedly misinterpreted the complicated filing requirement of the new rules. That solo practitioner, Mr. Richardson, candidly admitted this was the first filing deadline he missed in thirty-eight years as a securities practitioner.
- Upon learning that the report was late, Med-X immediately sprung into action to correct the mistake, filing the report within eighteen days (eleven business days) when the Commission's guidance indicates approximately 600 hours will be required to prepare the required report.
- It is highly unlikely that Med-X will again miss a deadline. There was no evidence of willfulness, recklessness or other disregard by Med-X of Regulation A's requirements, nor any evidence that this is likely to happen again. It is revealing that Med-X immediately took responsibility for its mistake, called the Commission to assure them the report was forthcoming, and promptly made the necessary filing. Indeed, the Company and outside counsel worked "around the clock" to get the report filed. This is not a company that has tried to dodge responsibility for a mistake; it has asked only that it not be treated punitively, in a way that unnecessarily harms the Company and its investors, for an isolated error.

Mr. Laporte testified that in his experience, the Commission does not typically seek such punitive sanctions for an isolated filing violation. And as discussed below,

while this case is a matter of first impression under the *new* Regulation A+, the history of enforcement actions under Regulation A supports Mr. Laporte: There are numerous cases under Regulation A where delinquent filers had the temporary suspension vacated once they filed the required report. That history, as well as the common-sense application of the *Gateway* factors, combined with the permissive wording of Rule 258, supports Respondent's request that this Court (i) deny the Commission's request for a permanent suspension, and (ii) vacate the temporary suspension that has prohibited Med-X from selling any shares under the Regulation A+ exemption for the last six months.

Any other result would unduly punish the Company and its investors. In addition, a permanent suspension under the facts of this case would deter small companies from using the Regulation A+ exemption, for fear that a single missed filing and the sale of even a single share of stock would result in a bar to any sales under Regulation A and (absent receiving a waiver) Regulation D, *no matter what* the circumstances.

Facts

A. Med-X, Inc.

1. Respondent Med-X, Inc., which was formed in February 2014, serves as an ancillary products company to the legal cannabis industry, including pesticide products and a digital media platform, and conducts research and development for compounds and extraction for medical purposes. (Testimony of Matthew Mills ("Mills Tr.") at 285:19-286:2; see, e.g., DIV. Ex. 3, Form 1-A Regulation A Offering Statement at page 9.)

2. Matthew Mills is the Company's Chairman of the Board, President and Chief Operating Officer. (Mills Tr. 285:14-15.) He is responsible for the day-to-day operations of the Company. The Company's board includes Dr. Allan Kurtz, a practicing physician

who is board certified in internal medicine and who, since 1986, has been the Medical Director of Warner Medical Center and the California Center of Longevity Medicine. (DIV. Ex. 3 at 24; DIV. Ex. 11, Form 1-K Annual Report at 22.) Another director is Dr. Morton Hyson, a board certified Neurologist in private practice, who also is a Clinical Assistant Professor at Touro University in San Francisco, CA and who serves as a Clinical Associate Professor at the University of Nevada, School of Medicine. Dr. Hyson is the inventor and grantee of three patents in the medical field. (Id.)

3. Three of the Company's four executive officers (including its CEO, President and COO, and CFO) have received no salaries since the Company's inception.[1] (Mills Tr. 286:7-12; DIV. Ex. 3 at 25; DIV. Ex. 11 at 23.) There currently are six directors, two of whom are "independent" as defined in Rule 4200 of FINRA's listing standards. (DIV. Ex. 3 at 26; DIV. Ex. 11 at 24.) As of September 1, 2016, the Company had three full-time employees and five part-time employees (four of whom are executive officers of Med-X.) (Mills Tr. 286:3-6; DIV. Ex.11 at 9.) This workforce is supplemented by eleven contract writers who support the marijuanatimes.org content. The Company plans to actively hire employees at such time as it has sufficient capital or financing to fund the expanded launch of its business plan. (Id.)

B. Regulation A+

4. On April 5, 2012, the Jumpstart Our Business Startups (JOBS) Act was signed into law by President Obama. The Act was designed to facilitate capital formation in smaller companies and required the SEC to write rules and issue studies in capital

---

[1] Jennifer Mills, the Company's Executive Vice President of Human Resources and Corporate Secretary, has received an annualized salary of $36,000 since April 2015. (Offering Circular at 25; 2015 Annual Report at 23.) She is the wife of Matthew Mills. (Offering Circular at 23; 2015 Annual Report at 21.)

[2] See SEC Spotlight at www.sec.gov/spotlight/jobs-act.shtml.

formation, disclosure and registration requirements.[2] On December 18, 2013 the SEC proposed rule and form amendments to implement Section 401 of the JOBS Act.[3] On March 25, 2015, the SEC "adopted final rules to facilitate smaller companies' access to capital. The new rules provide investors with more investment choices" and "update and expand Regulation A, an existing exemption from registration for smaller issuers of securities."[4] The new rules became effective on June 19, 2015.[5]

5. The updated exemption was designed to "enable smaller companies to offer and sell up to $50 million of securities in a 12-month period, subject to eligibility, disclosure and reporting requirements.[6] SEC Chair Mary Jo White said "It is important for the Commission to continue to look for ways that our rules can facilitate capital-raising by smaller companies."[7] The final rules, referred to as Regulation A+, provide for two tiers of offerings. Tier 1, for offerings up to $20 million in a 12-month period, and Tier 2 (which is relevant here) for offerings of up to $50 million in a twelve-month period.[8] An offering statement is qualified only upon action by the Commission (or the Division of Corporation Finance, pursuant to delegated authority) in the form of a "notice of qualification."[9]

---

2 See SEC Spotlight at www.sec.gov/spotlight/jobs-act.shtml.

3 Proposed Rule Rel. No. 33-9497, Dec. 18, 2013; *available at* www.sec.gov/rules/proposed/2013/33-9497.pdf.

4 SEC Press Rel. 2015-49; *available at* www.sec.gov/news/pressrelease/2015-49.html.

5 Final Rule, Rel. No. 33-9741, *available at* www.sec.gov/rules/final/2015/33-9741.pdf.

6 SEC Press Release 2015-49.

7 Id.

8 Id.

9 See Rule 252(e); Final Rules release at 142-44.

6. Issuers electing to proceed under Tier 2 are required to provide audited financial statements and to file annual (Form 1-K), semi-annual (Form 1-SA) and current event (Form 1-U) reports. Rule 257(b)(1) provides:[10]

> Each issuer that has filed an offering statement for a Tier 2 offering that has been qualified pursuant to this Regulation A must file with the Commission the following periodic and current reports:
>
> (1) Annual reports. An annual report on Form 1-K (§ 239.91 of this chapter) for the fiscal year in which the offering statement became qualified and for any fiscal year thereafter . . . . Annual reports must be filed within the period specified in Form 1-K.

Form 1-K General Instructions state:[11]

> Annual reports on this Form shall be filed within 120 calendar days after the end of the fiscal year covered by the report.

Thus, an annual report must be filed for the fiscal year in which the offering statement became qualified.

C. Med-X elects to raise capital by a Tier 2 offering.

7. Prior to the enactment of Regulation A+ Med-X utilized Regulation D (506(c)) to raise capital and begin research and development activities. (Mills Tr. 287:12-288:11; Testimony of Mark Richardson, Esq. ("Richardson Tr.") 256:23-247;15.) One of the drawbacks of a Regulation D offering is that shares can be sold only to "accredited investors," and the issuer itself is required to verify the accredited status of every investor – a representation by the investor that they meet the requirements is insufficient. (Richardson Tr. 247:16-248:7.) This verification is done by reviewing investors' tax returns, credit reports, financial statements, or by obtaining third-party verification from

---

[10] C.F.R. 230.257(b)(1).

[11] Form 1-K(A)(2); DIV. Ex. 21.

the investor's accountant, securities broker or advisor. (Richardson Tr. 248:7-12.) This is an onerous process and in the case of Med-X, required around eighteen months to raise approximately $1.1 million. (Richardson Tr. 247:2-15.) And unlike a Regulation A+ offering, shares sold pursuant to Regulation D are restricted and cannot easily be re-sold, depriving investors of liquidity as to their shares. (See Mills Tr. 296:25-297:12.)

8. Med-X wanted to pursue an offering under Regulation A+ to more rapidly raise capital and have access to more potential investors. (See Mills Tr. 288:12-289:6.) In August 2015, approximately two months after Regulation A+ went effective, Med-X filed an Offering Statement on Form 1-A. (E.g., Richardson Tr. 248:20-250:4; DIV. Ex. 1.) Because Med-X sought to raise up to $15 million, it could elect whether to proceed under Tier 1 (which has no ongoing reporting requirements) or Tier 2.[12] Med-X opted to proceed under Tier 2. (Offering Statement, DIV. Ex. 1 at p. 7.) Although Regulation A+ does not limit offerings to "accredited investors," the Offering Statement described the offering as intended for "Sophisticated Investors Only," and no sale could be made to an investor if the aggregate purchase price paid is more than 10% of the greater of the investor's annual income or net worth, not including the value of his primary residence. (See id. at cover page, page 30.)

9. The offering originally was set to terminate on March 15, 2016 unless extended for up to an additional 180 days. (Id.) As required, the Offering Statement included Med-X's audited financial statements as of December 31, 2014 (id. at F-1 through F-14), and unaudited financial statements as of June 30, 2015 (id. at F-15 through F-18). Page one of the Offering Circular contains a **"SUMMARY OF RISK FACTORS"** and states

---

12 SEC Press Release 2015-49.

that "The purchase of shares of our common stock involves substantial risks." The summary of risks is four pages long, and the more detailed risk section contains seven pages of risk factors. (Id. at pages 1-4; 12-18.)

10. By letter dated September 28, 2015, the SEC's Division of Corporate Finance indicated it had only one comment to Respondent's Offering Statement, asking Med-X to revise the use of proceeds section to "estimate the amounts you intend to spend on each identified use," and to "provide information about the priority of each of these uses in the event that less than the maximum amount is raised in the offering." (Letter from S. Hayes to Dr. Toomey, dated September 28, 2015, DIV. Ex. 2; Richardson Tr. 250:9-251:1.) Mr. Richardson testified that it is unusual in an offering document of this size – around 75 pages not including exhibits – to receive only one comment from the SEC. But Med-X was "very diligent about preparing that document." (Richardson Tr. 250:5-8, 251:2-7.)

11. Thereafter, Respondent filed an Amended Offering Statement on October 15, 2015, providing details regarding the use of proceeds from the offering and the priority in which they would be used.[13] (Amended Offering Statement, dated October 12, 2015, DIV. Ex. 3, at pages 7-8; Richardson Tr. 250:22-251:1.)

12. By letter dated October 30, 2015, Med-X requested that the SEC declare its Offering Statement "qualified" on November 3, 2015. (Richardson Tr. 251:8-16.; DIV. Ex. 4.) On November 3, 2015, the SEC issued a "Notice of Qualification" (DIV. Ex. 5), meaning Med-X was one of the first few issuers qualified to begin offering shares

[13] The subscription period indicated that the offering would terminate on April 12, 2016 unless extended by Med-X. (Id. at 31.)

pursuant to Regulation A+. (See Richardson Tr. 251:17--24; Testimony of Sebastian Gomez Abero ("Gomez Tr.") 79:7-13.)

13. Instead of immediately commencing the offering, Med-X decided to engage FundAmerica Securities LLC, a registered broker-dealer, to provide compliance-related services. (Richardson Tr. 251:25-252:22; Mills Tr. 290:7-22 ("Bringing a broker-dealer on board allowed Med-X "to be able to just be super compliant.").) These services included, for example, a review of all subscription documents to insure eligibility standards were met. (Richardson Tr. 252:9-14.) FINRA was required to review FundAmerica's role,[14] and as that role evolved, Med-X filed amendments to the Company's Offering Statement to address the changes to Med-X's Plan of Distribution. (Richardson Tr. 252:23-253:10.) According to Mr. Richardson, the final document before shares were actually sold "had to be just right." (Richardson Tr. 252:22.)

14. This resulted in three post-qualification amendments to the Offering Statement: on December 4, 2015 (RESP. Ex. B), December 21, 2015 (RESP. Ex. C), and January 26, 2016 (RESP. Ex. D). Although already qualified to sell shares, Med-X would not begin doing so until the post-qualification amendments were approved by the SEC. Med-X "wanted to make sure that the offering statement was absolutely correct." (Richardson Tr. 254:24-25.)

15. That approval came on January 29, 2016, when Mr. Richardson received a call from the SEC indicating that the "post-effective amendments" were now "qualified." (RESP. Ex. H; Richardson Tr. 253:11-254:5.) This was wonderful news to Med-X – its

[14] This is referred to as a FINRA Rule 5110 review.

long-delayed offering could finally commence. On February 9, 2016 Med-X launched its offering and started selling shares to the public.

16. However, the lengthy post-qualification process meant that Med-X needed to extend the subscription period for the offering. So on February 10, 2016, Med-X filed a change to the subscription period pursuant to Rule 253(g)(2) extending the termination to July 14, 2016. (Form 1-A, RESP. Ex. E at 31.) On July 11, 2016 (during the period the annual statement was, unknown to Med-X, delinquent), Med-X made another SEC filing extending the termination to October 14, 2016.[15] (Form 1-A, DIV. Ex. 6 at 3.)

D. Med-X learns that its initial annual report under Rule 257(b)(1) is late.

17. In the summer of 2016, Med-X and its outside counsel began preparing the Company's *semi-annual* report on Form 1-SA that was due on September 30, 2016. (Richardson Tr. 257:22-258:5; Mills Tr. 293:24-294:2.) The SEC's forms estimate that compliance with this Regulation A+ requirement will require 187 hours. (DIV. Ex. 12, cover page.)

18. On Friday, September 2, 2016, Med-X's CFO emailed Mr. Richardson (who was responsible for all SEC filings), stating: "Attached is a letter received today. **Please review and call us ASAP!**" (RESP. Ex. G1, emphasis added; Richardson Tr. 255:1-256:2.) The reason for the urgency was evident. Attached to the email was a letter addressed to Med-X's CEO, dated August 30, 2016 (sent via certified mail), from Tim Henseler, Chief, Office of Enforcement Liaison, Division of Corporation Finance, informing him that:

---

[15] Pursuant to Rules 251(d)(3)(i)(F) and 252(f), Med-X could extend the offering period up to and including January 28, 2017 and could file additional post-qualification amendments to extend it for up to two more one-year periods.

> We are writing to address the reporting responsibilities of the referenced company under Regulation A. . . .
>
> The Commission qualified a Tier 2 securities offering by [Med-X] under the Regulation A exemption on November 3, 2015. According to our records, [Med-X] is not in compliance with the requirement of Tier 2 of Regulation A to file an annual report under 17 CFR § 230.257(b)(1). An annual report was due April 30, 2016, 120 calendar days after the end of [Med-X's] fiscal year. *See* 17 CFR § 239.91; General Instruction A.(2) of Form 1-K. Please be aware that the Commission may, without further notice, issue an order temporarily suspending [Med-X's] Regulation A exemption under 17 CFR § 230.258. If such an order is issued by the Commission, you will receive notice of the temporary suspension and be given an opportunity to request a hearing before the Commission.
>
> If you wish to speak with a member of the Commission staff about this matter, please contact the undersigned at (202) 551-2015 or Sebastian Gomez Abero at (202) 551-3460.

(DIV. Ex. 7.) No deadline or grace period to fix the deficiency was provided nor was there any follow-up letter. As it turns out, this was the first letter by the SEC addressing a late filing under the new Regulation A+. (Gomez Tr. 92:7-93:6.)

19. Med-X officers were incredulous – "very stressed, to say the least" – that a filing deadline had been missed; lacking any internal legal department, they relied entirely on Mr. Richardson to insure compliance with such requirements. (See Mills Tr. 292:5-12; Richardson Tr. 258:10-16, 260:19-24.) When Mr. Richardson received the Henseler letter, he thought there must be a mistake. He believed the 120-day period to file the annual report ran from the end of **2016** – the fiscal year when the *final* post-qualification amended Offering Statement filed on January 26, 2016 was qualified.[16] (Richardson Tr. 257:6-258:1, 260:3-18.) It was this amended offering statement, as qualified in February 2016, pursuant to which the Company began selling shares. (Richardson Tr. 253:2-

[16] See RESP. Ex. H, a voicemail from the SEC to Richardson dated January 29, 2016 stating that the post-effective amended offering statement was now "qualified." No securities were offered for sale until after this January 2016 qualification was received from the SEC.

254:25; Mills Tr. 290:3-291:8.) Under this interpretation, the first annual report would be due in April **2017.** (Richardson Tr. 260:17-18, 266:16-17.) Upon receiving the Henseler letter, Richardson researched the new statute's filing requirements, which he hadn't reviewed in many months, and was mortified to discover that he was wrong – the filing was indeed due on April 30, 2016. (See Richardson Tr. 256:14-16 ("I realized that the [SEC] was correct, and it was my error.").)

20. Richardson felt "[i]ncredibly upset, because we had been extremely diligent and cautious and took the extra time to do the project properly, and we [then] had this mistake." (Richardson Tr. 256:25-257:5.) In thirty-eight years as a securities practitioner he had never missed a filing deadline. (Richardson Tr. 257:6-13.) When Richardson told Med-X about his error "they were very upset" because "we had gone out of our way to be cautious." (Richardson Tr. 258:13-16.)

21. This cautiousness was a tone set at the top. The Company's President, Mr. Mills, testified that not only was it important that Med-X missed a filing (Mills Tr. 293:12-14), but it was a particularly serious problem when a company like Med-X (in the cannabis industry) misses a regulatory filing. (Mills Tr. 293:15-20.) Mr. Mills instructed Mr. Richardson to immediately call the SEC, as per Mr. Henseler's August 30, 2016 letter, and assure them that the problem would be fixed. (RESP. Ex. G2; Richardson Tr. 280:24-282:2; Mills Tr. 292:19-293:5.)

22. On September 6th, the first business day after receiving notice from the SEC of the delinquency (September 5th was the Labor Day Holiday), Mr. Richardson called and left a voicemail message for Mr. Henseler, stating (as recorded by the SEC):

> I just want to reassure you that we will be filing our 1-K and our 1-S within the next couple of weeks to be completely caught up on Med-X.[17] I was going off the date of the last post-effective amendment so I didn't -- I didn't realize we had an annual report due on April 30th. But I acknowledge your correspondence and we're going to take care of it. If you have any questions you can call me at the law office 310-393-9992. Thank you Tim. Appreciate it.

(RESP. Ex. G3; Richardson Tr. 281:3-282:2.) From the very start, Mr. Richardson and the Company communicated promptly and honestly with the SEC, accepting responsibility for the error and committing to fix it. (See id.) Mr. Richardson did not hear back from Mr. Henseler. (Richardson Tr. 282:18-20.)

23. In the meantime, Mr. Richardson and the Company devoted all their energies to completing the required filings, which the SEC itself estimated combined would require approximately 787 hours.[18] (Richardson Tr. 258:21-23 ("We worked night and day for two weeks . . . .").) But because Med-X had already begun preparing the semi-annual report that was due on September 30th, and because Richardson – a solo practitioner -- was instructed to work around the clock, both reports were filed on September 20, 2016.[19] (Richardson Tr. 258:13-23.) Thus, the late report and the semi-annual were completed in just 18 days (11 business days). (Richardson Tr. 258:24-259:2; Mills Tr. 293:9-11 ("We just, again, circled wagons, went right to work on this thing with our CFO, our accounting firm. Everybody got involved in this. We really went through the ringer. Eighteen calendar days later, we were filing.").) Richardson testified that after

---

[17] As previously noted, Med-X had already begun working on its semi-annual report on Form 1-SA that was due on September 30, 2016. (Richardson Tr. 257:22-258:5; Mills Tr. 293:24-294:2.)

[18] Final Rule, Rel. No. 33-9741, at pp. 328, 330; Form 1-K, Form 1-SA. (See Richardson Tr. 259:3-10.)

[19] The filings were actually made after 5:30 September 19, 2016 and filed-stamped by the SEC on September 20, 2016. (See Richardson Tr. 258:2-9; see generally Gomez Tr. 81:12-23.)

receiving the notice of a delinquent filing, he spent ninety percent of his time preparing the annual and semi-annual reports for filing. (Richardson Tr. 261:8-11.)

24. On September 19, 2016, one day before the delayed report was filed, 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. (DIV. Exs. 9, 9A, 10, 10A.)

25. On September 21, 2016, Med-X requested a hearing pursuant to Rule 258(b)(2) to vacate the temporary order of suspension "in light of the fact that on September 19, 2016, at 5:53 PM EDT we filed our Annual Report on Form 1-K . . . ." Thus, Med-X was "completely current with its filing requirements under Rule 257 of Regulation A." (DIV. Ex. 13.)

26. The temporary suspension has resulted in significant hardship for the Company. First, the offering was suspended with Med-X raising only $873,000 of the $15 million it sought. (DIV. Ex. 17.) The media has followed the story, and "seems to think that there is something terribly wrong with Med-X, that we could not be going to this proceeding for just a late filing." (Mills Tr. 294:23-295:15.) The negative press coverage that assumes "there must be something wrong" for the SEC to move so aggressively caused Med-X's broker-dealer to pull out of an agreement to participate with Med-X on the rest of the $14 million capital raise. (Mills Tr. 295:4-10.) With the pendency of the SEC proceedings, Med-X cannot raise capital. (Mills Tr. 295:12-14.) And if a permanent suspension is ordered, even assuming a waiver can be obtained as to Regulation D, resort to that exemption will create liquidity issues and "will definitely slow us down. We'll

have to stop operations, save all the capital that we have so we could file and get the company public." (See Mills Tr. 296:25-297:12.)

27. Further, in November 2015, California passed Proposition 64, that will allow for the recreational use of marijuana. Prior to the suspension, Med-X was well positioned to expand its business and compete successfully in this newly created market. (Mills Tr. 295:16-296:6.) Now, Med-X is quickly losing ground to its competitors, as even the stigma of a suspension crimps its ability to raise desperately needed funds. If the company cannot quickly re-enter the capital-raising process under Regulation A+, there is a strong likelihood it will not survive. (See Mills Tr. 296:8-12.)

28. A permanent suspension will trigger "bad actor" status for Med-X under Regulation D and prevent Med-X from using that exemption. (Gomez Tr. 107:22-109:7; Laporte Tr. 192:21-25.) It is possible that a waiver may be obtained from the SEC's Office of Small Business Policy ("Small Business Office") allowing the Company to raise funds pursuant to Regulation D, but there is no guarantee that the Small Business Office will recommend a waiver. (Gomez Tr. 109:8-19; Laporte 226:12-227:17.) If a permanent suspension is issued, Med-X's current offering will be terminated, and the Small Business Office cannot issue a waiver to allow Med-X to pursue a Regulation A offering. (Gomez Tr. 140:4-24.) Instead, the Company will have to seek a waiver from the Commission itself, in proceedings that have yet to be defined. (E.g., Gomez Tr. 138:13-139:9.)

29. Indeed, after the first day of hearings in this matter, Med-X applied to the Small Business Office for a waiver. (Gomez Tr. 138:1-9.) This apparently prompted the "clarifying" testimony of Mr. Gomez that the Small Business Office could only grant

waivers as to disqualification under Regulation D, but could not waive a permanent suspension of Regulation A+. (See Gomez Tr. 133:20-134:11.)

30. A permanent suspension under Regulation A+ for this late filing would potentially be catastrophic for the Company and its investors. (Mills Tr. 296:9-12; Laporte Tr. 225:20-226:11.)

ARGUMENT

The issue here is whether Regulation A+ automatically *requires* a permanent suspension of the exemption, without consideration of ameliorating facts and circumstances, when an issuer (i) is late in filing a required report, and (ii) during the period when the report is late offers to sell or sells any shares of its stock (together, the "Late Filing Scenario"). Respondent respectfully submits that the draconian penalty of a permanent suspension of the exemption, which also results in disqualification as to the Regulation D exemption, is (i) *not* required by the plain language of the rules, (ii) is inconsistent with the long history of Regulation A, and (iii) is inconsistent with customs and practice of the Commission in addressing late filings under other sections of the securities laws. Equity – and precedent -- strongly favors consideration of the relevant facts and circumstances to determine whether a permanent suspension should be applied, rather than a one-size-fits-all automatic suspension. And here, ameliorating facts and circumstances weigh heavily *against* a permanent suspension that could destroy this first-time violator of a new statute and, in doing so, harm the company's thousands of investors.

A. The JOBS Act is designed to encourage capital raising by small businesses.

As a preliminary matter, it is relevant to put Regulation A+ in context. "Regulation A+" is a product of the Jumpstart Our Business Startups Act (the "JOBS Act"). The JOBS Act was intended to encourage capital raising by small businesses by easing various securities regulations. (Laporte Tr. 162:16-24; RESP. Ex. I at ¶ 1.) Few companies were utilizing Regulation A in the past couple of decades, and Title IV of the JOBS Act required the SEC to amend Regulation A to create an expanded exemption from registration under the Securities Act, in order to enhance the ability of smaller companies to raise money.[20] (Id.) The goal was to encourage small businesses to use Regulation A to raise capital, providing a kickstart to the economy and creating jobs by eliminating perceived barriers to funding.

The SEC's new rules with respect to Regulation A went into effect on June 19, 2015 – less than three months before Med-X submitted its proposed Offering Statement. (See pp. 7, 9, *supra*.) These new rules are referred to as "Regulation A+" – a phrase coined by Med-X's expert Gerald Laporte when he worked on the amendments to Reg A. (Laporte Tr. 162:25-163:17.) The new Tier 2 of Regulation A+ "allows companies to offer and sell securities to the public, but with more limited disclosure requirements than what you currently would expect from publicly reporting companies. In comparison to registered offerings, smaller companies in earlier stages of development may be able to use this rule to more cost-effectively raise money."[21]

---

[20] Jumpstart Our Business Startups (JOBS) Act of 2012, Pub. L. 112-106, April 5, 2012; and "Investor Bulletin: Regulation A," Securities and Exchange Commission, July 8, 2015 ("Investor Bulletin: Regulation A"), *available at* https://www.sec.gov/oiea/investor-alerts-bulletins/ib_regulationa.html.

[21] *E.g.*, Investor Bulletin: Regulation A.

Of course, while the JOBS Act and the rules implemented thereunder are designed to facilitate capital formation by smaller businesses, the Act and regulators must also address investor protection, market integrity and market confidence. [22] The rules under Tier 2 of Regulation A that went into effect in June 2015 are designed to increase the options available to small businesses to publicly raise capital, including lessening the periodic reporting requirements that would be triggered by full registration of a securities offering under the Securities Act, while instilling market confidence.[23]

The Form 1-A Offering Statement (which includes an offering circular) is the primary disclosure document in Regulation A+ offerings. It contains a wealth of information to assist investors in learning about the company they are investing in, such as information about the offering and the securities offered, the risks of the investment, use of proceeds, any selling shareholders, and the company's business, management, performance, plans and financial statements. All Regulation A+ investors receive this Offering Statement before they are allowed to invest. [24] Here, Med-X's original qualified qualified Offering Statement is approximately seventy-five pages, and addresses virtually every aspect of the Company's business and the anticipated use of funds from the offering. (DIV Ex. 3; see Richardson Tr. 249:12-250:8.) This critical document was carefully prepared to fully comply with the new rules (see Richardson Tr. 251:2-7) and

---

22 2016 Government-Business Forum on Small Business Capital Formation, Opening Remarks by Commissioner Kara M. Stein, Public Statement, November 17, 2016 ("2016 Small Business Forum") available at https://www.sec.gov/news/statement/stein-opening-remarks-small-business-forum.html, ("[Reg A+ and other] initiatives were adopted with the purpose of increasing the options available to small businesses to raise capital. These initiatives also incorporated the Commission's consideration of investor protection, market integrity and market confidence.").

23 Id.

24 Investor Bulletin: Regulation A.

the Commission had only one comment – requesting an expanded Use of Proceeds section -- before qualifying the Offering Statement. (Id.)

Companies offering securities under Tier 2 of Regulation A (wherein they offer up to $50 million in securities during any 12-month period) also are subject to ongoing reporting requirements under the new Rule 257:

> Like public companies that regularly disclose their financial results, companies raising money under Tier 2 will also file regular reports with the SEC. However, unlike the quarterly reporting that you may be use [sic] to, Tier 2 companies are only required to file a semiannual and annual report as well as interim current reports upon the occurrence of certain enumerated events."[25]

These reports are the 1-K (annual report), 1-SA (semiannual report), and 1-U (current report).[26] Pursuant to newly enacted Rule 257(b)(1), and the General Instructions to Form 1-K, the annual report must be filed for the fiscal year in which the offering statement became qualified, and within 120 days after the end of the fiscal year covered by the report. (See pp. 6-7, *supra.*)

B. Regulation A+ does not by its terms automatically impose a permanent suspension for violations.

Section 230.258(a) of Regulation A provides that the "Commission may at any time enter an order temporarily suspending a Regulation A exemption if it has reason to believe that" among a number of things, "(1) . . . the terms, conditions or requirements of Regulation A have not been complied with."[27] Here, Respondent does not dispute that

---

[25] Investor Bulletin: Regulation A; and 17 C.F.R. § 230.257.

[26] In considering the proposed revisions to Regulation A, and those regarding periodic reporting in particular, the SEC noted "We are mindful that an ongoing reporting regime that is suitable for one type of entity and its investor base may prove too onerous for another entity or provide its investors with more or more frequent information than they necessarily need or seek, resulting in undue costs to the issuer." See Proposed Rule Rel. No. 33-9497, at pp. 136–37.

[27] 17 C.F.R. § 230.258(a)(1).

the SEC had reason to believe that Med-X had not complied with Rule 257 by filing its initial annual report by April 30, 2016.

Rule 258(b) provides that "upon the entry of an order under paragraph (a) of this section, the Commission will promptly give notice to the issuer . . . (1) That such order has been entered, together with a brief statement of the reasons for the entry of the order; and (2) That the Commission, upon receipt of a written request within 30 calendar days after the entry of the order, will . . . order a hearing at a place to be designated by the Commission.[28]

Rule 258(c) and (d) address the suspension order now being sought:[29]

> (c) Suspension Order. If no hearing is requested and none is ordered by the Commission, an order entered under paragraph (a) of this section shall become permanent on the 30th calendar day after its entry and shall remain in effect unless or until it is modified or vacated by the Commission. Where a hearing is requested . . . the Commission will, after notice of and opportunity for such hearing, ***either vacate the order or enter an order permanently suspending the exemption.***"
>
> (d) Permanent suspension. The Commission ***may,*** at any time after notice of and opportunity for hearing, enter an order permanently suspending the exemption for any reason upon which it could have entered a temporary suspension order under paragraph (a) of this section. Any such order shall remain in effect ***until vacated by the Commission.***

Under Rule 258(d), the Commission "may" enter an order permanently suspending the exemption, but nothing requires that result. (See also Laporte Tr. 183:7-18.) The language regarding a permanent suspension is *permissive* not mandatory, and this Court has the discretion to vacate the temporary suspension rather than permanently suspend the exemption. Indeed, the SEC's primary witness conceded as much:

---

28 17 C.F.R. § 230.258(b)(1), (2).

29 17 C.F.R. § 230.258(c), (d) (emphasis added).

MR. MOYLE: Well, 258 is the rule that deals with temporary and permanent suspension. Right?

MR. GOMEZ: That's correct. The other rule that I've been trying to get out is Rule 260.

MR. MOYLE: Right. We'll get to that, but Rule 258 talks about – there's nothing in Rule 258 that says that there's an automatic suspension with no opportunity to present ameliorative facts that a court like this can consider in deciding whether or not there should be a permanent suspension or whether a temporary suspension should be vacated. Right?

MR. GOMEZ: That's correct. Rule 258 sets forth that if the Commission has reason to believe that, among other things, there is a violation of the rules, then the Commission can enter a temporary suspension. *It then provides an opportunity for hearings like this one here for the Commission or the judge to make a determination as to whether that temporary suspension should be made permanent or should be vacated.*

(Gomez Tr. 77:17-78:12; emphasis added.)

If, as the SEC claims, there is essentially "strict liability" in a suspension proceeding for a particular violation of Regulation A+, with no reference to ameliorating factors, the rules clearly would have indicated as much. At a minimum, Rule 258 would have required that a "permanent suspension *shall* be entered for any violation" (or for certain, enumerated violations), rather than using permissive language that leaves complete discretion to this Court. And the Commission presumably would have notified investors (as part of its rule-making function and/or in the context of issuers' mandatory risk disclosures) requirements in issuers' risk disclosures) that violations of Regulation A+ *shall* result in a permanent suspension of the exemption, with collateral disqualification under regulation D, all of which could adversely impact the issuer's ability to raise capital in the future, exposing investors to risk of loss of their investment.

Mr. Laporte, the Chief of the SEC's Office of Small Business Policy from 2002 through 2013 and the only expert in this matter, indicated that the language of 258 is

permissive – *allowing* but not *requiring* the imposition of a permanent suspension for violations of Regulation A+. (Laporte Tr. 184:5-25; see RESP. Ex. I at ¶ 8 n.9.) Indeed, requiring a permanent suspension *without* considering ameliorating circumstances would be entirely *inconsistent* with regulatory custom and practice addressing late periodic filings. (Laporte Tr. 185:16-23; RESP. Ex. I ¶ ¶ 1, 8-9.) Laporte testified that in his experience, the SEC *always* inquires into extenuating facts and circumstances before imposing a serious sanction like a permanent suspension. (Laporte Tr. 185:16-20.) Further, he opined that once a Rule 257 reporting violation has been remedied, *there is no basis for a permanent suspension under Rule 258 or even proceedings addressing a permanent suspension, even when a temporary suspension was appropriate."*[30] (Laporte RESP. Ex. I at ¶ 8; emphasis added; see Laporte Tr. 172:21-173:4, 176:4-12.)

C. Numerous late-filing cases under pre-amendment Regulation A have considered the relevant facts and circumstances before vacating temporary suspensions.

Mr. Laporte's testimony is supported by the history of Regulation A. During the hearing, Mr. Laporte testified that he was unaware of any authority which exists for his opinion that a court should look to various extenuating or aggravating factors when considering a Regulation A+ suspension case. (Laporte Tr. 241:3-13). Instead, Mr. Laport relied on analogous scenarios under the Act along with his 38 years of experience as a securities attorney, including 11 years as Chief of the Office of Small business policy and involvement in the drafting of Regulation A+ to determine that "common sense" dictates consideration of the relevant facts and circumstances when deciding whether to

[30] As previously noted, nothing in the language of Rule 258 (and nothing in the history of its enactment) provides a basis for – much less *requires* -- suspending a Regulation A exemption for a single historic failure to comply with a periodic reporting requirement of Regulation A once the issuer has complied with the reporting requirement. See 17 C.F.R. § 230.258.

permanently suspend a Regulation A+ exemption for a single late filing. (Laporte Tr. 242:1-10.)

Although this case addresses the first temporary suspension issued under the new Regulation A+, Mr. Laporte's "common sense" approach has been applied historically by the Commission to vacate temporary suspension orders, even where there has been an admitted violation of Regulation A periodic reporting rules. In fact, as discussed below, vacating temporary suspension orders despite violations of mandatory reporting requirements occurred throughout the 1950s, 1960s and 1970s, the "boom years" of Regulation A.[31]

In those Regulation A hearings, the issue was whether to vacate a temporary suspension or permanently suspend a company that failed to file a mandatory periodic report as required by Regulation A – the very issue being addressed here (albeit applying slightly different rules). Consequently, this precedent serves as a guidepost to the Commission's historic treatment of late filings that violate Regulation A, and is insightful to assessing the appropriate relief here.

1. Regulation A precedent.

During the period July 1933 through April 1934, the Commission adopted a series of Rules that exempted particular classes of securities from registration. These Rules were collected in the form of regulations and embodied as Regulation A in the General Rules and Regulations, effective March 15, 1936. This first version of Regulation A exempted certain classes of offerings not exceeding $100,000, provided that the person

---

[31] See generally J. William Hicks, *Exempted Transactions Under the Securities Act of 1933* (2016) § 6.1, addressing Regulation A's preeminence among the various exemptions during this period.

claiming the exemption first filed a prospectus with the Commission via a letter of notification.[32]

Over time, the permitted offering size increased[33] as did the number of offering under Regulation A.[34] In 1953 the SEC approved revisions to Regulation A including a new mandatory requirement that issuers file a semi-annual sales report (on Form A-2) with the Commission showing progress of the offering.[35] Any failure to file this semi-annual report would be a violation of Regulation A rules. This new reporting Rule 224 stated that:

> Within 30 days after the end of each six-month period following the commencement of the offering of the securities under this regulation, the issuer or other person on whose behalf the securities are offered **shall file** with the Commission four copies of a report on Form 2-A containing the information called for by such form.[36]

To give teeth to the new semi-annual reporting rule and to help deter fraud and other abuse, the Commission also enacted new Rule 223, which (like current Rule 258) granted the Commission discretion to suspend the Regulation A exemption in cases where (i) the terms and conditions of the exemption have not been met; (ii) the offering circular or other material filed pursuant to the regulation is fraudulent; (iii) fraud or deceit is being perpetrated in the sale of the securities; or (iv) some event has occurred which would have made the exemption unavailable had it occurred prior to the filing of the notification.[37]

---

32 Id.
33 Id.
34 See SEC Annual Report for fiscal year ended June 30, 1945, p.7 and p.7 fn.9.
35 SEC Release No. 3466, (1953) LEXIS 8, p. 21-22 (emphasis added).
36 Id.
37 Id. p. 2-3.

This Rule 223, which first implemented discretionary suspension power, was the genesis of what is now Rule 258 and comparing the two rules shows that much of the pertinent original language remains intact. In particular, Rule 223 implemented the permissive language which gave the Commission discretion to temporarily or permanently suspend an issuer's exemption for failure to comply with the rules. (The Commission "may enter an order temporarily suspending the exemption" and "The Commission may... enter an order permanently suspending the exemption ").

Notwithstanding the mandatory language of Rule 224 requiring issuers to file semi-annual reports within a set timeframe, reported decisions and Commission releases demonstrate the Commission routinely applied its discretion under Rule 233 (the predecessor to Rule 258) to vacate temporary suspensions that were issued because of a failure to file a mandatory report. For example, in *Simplex Precast Industries, Inc.*, [38] the Commission temporarily suspended Simplex's exemption from registration pursuant because the terms and conditions of Regulation A had not been complied with when Simplex failed to file the required semi-annual reports.[39]

Simplex thereafter sought to have the temporary suspension lifted, and in its decision vacating the suspension the Commission stated:

> The Commission's suspension order was based upon the failure of Simplex Precast to comply with the terms and conditions of Regulation A, namely, its failure to file the required semi-annual reports of stock sales pursuant to the offering. Subsequently, such a report was filed reflecting the sale of 12,925 shares. In addition, the company filed a request that the suspension order be vacated, *accompanied by information to establish that the failure to file the report was due entirely to inadvertence. In view of the foregoing, the Commission determined to lift the suspension.*[40]

---

38 *Simplex Precast Industries, Inc.*, SEC Release No. 33-3824, 1957 WL 7723.

39 Id.

40 *Simplex Precast Industries, Inc.*, SEC Release No. 33-3850, 1957 WL 7748 (emphasis added).

Thus, the Simplex case largely mirrors that of Med-X as well as the approach to such matters described by Mr. Laporte. Simplex violated a mandatory term and condition of Regulation A by failing to file a semi-annual report.[41] Thereafter, Simplex filed the inadvertently missed semi-annual report. After temporarily suspending Simplex from the exemption, the Commission exercised its discretion under Rule 223 and vacated the suspension. With no evidence of fraud, misrepresentations, prior missed filings, or investor complaints, and specifically taking into account the ameliorating fact that the error was inadvertent, the Commission vacated the temporary suspension once the filing was made.

Similarly, the Commission vacated its prior order temporarily suspending a Regulation A exemption with respect to a public offering of 150,000 shares of common stock by Red Lane Calcareous Sinter Co., Inc.[42] There, too, the temporary suspension order was based on the company's failure to comply with mandatory terms and conditions of Regulation A by reason of its failure to file the A-2 semi-annual report of stock sales pursuant to Rule 224. Despite the violation of the mandatory reporting rule, the Commission vacated the temporary suspension noting in its Release that:

> Subsequently, such a report was filed which complies with the requirements of the rule; and the Commission concluded that it was **appropriate in the public interest** to lift the suspension order.[43]

Just as Mr. Laporte suggested, to assess the appropriate sanction a court or the Commission looks at all the facts and circumstances, the "totality of circumstances."

---

41 Simplex sold 4.3% of its offering (12,925/300,000) with no report on file compared to 1.6% for Med-X (214,818,15,000,000).

42 *Red Lane Calcareous Sinter Co., Inc.*, Release No. 33-4337, 1961 WL 61566.

43 Id. (emphasis added.)

(Laporte Tr. 180:7-19.) Moreover, Mr. Laporte opined that based on his experience, a permanent suspension under Regulation A for a late periodic filing was not mandated. (Laporte Tr. 184:5-8.) Instead, before imposing a serious sanction like a permanent suspension the Commission should always inquire into the extenuating facts and circumstances. (Laporte Tr. 185:16-20.)

It is noteworthy that this Regulation A decision *specifically* references the "public interest" analysis urged by Med-X. Here, Med-X is not suggesting that a violation of a periodic reporting rule should be ignored; but instead is asking this Court to weigh the facts and circumstances of the violation against potential harm to the company and its investors to determine whether a permanent suspension (as opposed to the "time-served" deterrence) is in the public interest.[44]

In a similar case involving Champion Ventures, Inc., the Commission vacated an order temporarily suspending the company's Regulation A exemption. It did so after the company belatedly filed the required report, notwithstanding the company's (i) original failure to file and (ii) failure to cooperate with the Commission.[45] In the present case, unlike in *Champion Ventures*, there are no allegations that Med-X failed to cooperate with or respond to the Commission. In fact, almost immediately after receiving notice of the delinquent report, Med-X acknowledged the error, informed the Commission that the report would be promptly filed, and proceeded to correct the mistake within eighteen days. (See page 7, ¶ ¶ 22-23, *supra.*) On these undisputed facts, it would appear that Med-X should be treated at least as equitably as *Champion Ventures*.

---

[44] The temporary suspension imposed on Med-X has already been a harsh penalty, with Med-X unable to sell shares under the exemption for more than six months, not to mention reputational harm and significant legal fees (which were not a budgeted expense).

[45] *Champion Ventures, Inc.*, Release No. 33-4316, 1961 WL 61545.

In the Matter of William Baxter and Edward Friedman As The Mandingo Company, is also instructive.[46] There, the Commission was asked to vacate a temporary suspension where an issuer failed to file the required semi-annual sales reports pursuant to Regulation A.[47] After receiving notice of the suspension Baxter filed the reports, entered a stipulation of facts and requested that the temporary suspension order be vacated. In rendering its decision, the Commission noted:

> It is not disputed that the issuer failed to file a report within the time required by Rule 260, despite repeated requests from our staff that it do so. The sales reports which must be filed in connection with a Regulation A offering *are important because they are a means of informing us and public investors as to how invested funds have been employed, the activities of the issuer, and other significant data. Rule 261 of Regulation A specifically provides that failure to file such a required report may be a basis for a permanent suspension.*[48]

The Commission noted that no allegation was made that offering circular or the semi-annual report were deficient (missing items, misleading, containing false statements). Thus, even when a failure to file a required report *specifically* was grounds for a permanent suspension, the Commission concluded that after Baxter filed the missing semi-annual report "*under all the circumstances* we do not consider it necessary to make the temporary suspension permanent."[49] Once again, consideration of all the "facts and circumstances" was appropriate in a case against an issuer that failed to file an important and mandatory report in violation of Regulation A.

Med-X's request to vacate the temporary suspension after six months of proverbial "time-served" is similar to these Commission hearings which vacated a

---

[46] *In the Matter of William Baxter and Edward Friedman As The Mandingo Company* SEC Release No. 33-4783, 1965 WL 87562.

[47] In this case, the semi-annual reports were required under then-Rule 260 and suspensions were brought under then-Rule 261.

[48] *In the Matter of William Baxter and Edward Friedman As The Mandingo Company* SEC Release No. 33-4783, 1965 WL 87562 (emphasis added).

[49] Id. (emphasis added.)

temporary suspension despite the issuers' violation of Regulation A rules which were necessary to maintain the exemption. The Commission's decisions to vacate the temporary suspensions in *Simplex, Red Lane, Champion Ventures* and *William Baxter and Edward Friedman As The Mandingo Company* are consistent with Mr. Laporte's opinion, based on his experience, that extenuating circumstances such as the *Gateway* factors should be considered in Regulation A suspension hearings like this. (See Laporte Tr. 240:22-241:10.) These historic Regulation A cases support Mr. Laporte's testimony that reasonable application of the *Gateway* "public interest" analysis is "common sense." (See Laporte Tr. 242:2-10.) They are consistent with Mr. Laporte's unrebutted testimony that the SEC "always" considers extenuating facts and circumstances before issuing a permanent suspension. (Laporte Tr. 185:16-23.)[50] And they support his testimony that "I didn't think that just because there were sales, even if they were violations of the registration provisions of Section 5, that that would necessarily require the issuance of a permanent suspension . . . ." (Laporte 216:7-11.)

The cases are reasoned guidance that a violation, even a violation of an important and mandatory rule under the Regulation A exemption, should not "*necessarily* result" in a permanent suspension as the Division of Enforcement demands. (Div. of

---

[50] Other cases under Regulation A where the temporary suspension was vacated include, for example, *Russell Janney, General Partner of Frontier Company,* SEC Release No. 33-4485, 1962 WL 69477 ("The suspension was based upon Janney's failure to file semi-annual reports of sales of partnership interests, as required; and the suspension was lifted following the filing of such reports."); *British Industries Corporation,* SEC Release No. 33-3787, 1957 WL 7686 ("the suspension order was issued by reason of the failure to comply with a requirement of the Regulation that semi-annual reports of stock sales be filed. Subsequently, a report of sales was filed, accompanied by information establishing that the failure to file such reports was due to inadvertence. A request also was made that the suspension order be vacated, which was granted by the Commission."); and *Micro-Mechanisms*, SEC Release No. 4306, 1960 SEC LEXIS 162 ("The suspension order was based upon the company's failure to comply with a requirement of the Regulation for the filing of a Form 2-A report of sales of stock pursuant to the exemption. Subsequently, such a report was filed which complies with the Regulation; and the Commission concluded that it was appropriate to vacate the suspension order.")

Enforcement's Pre-Hearing Brief at 14.) The historic approach to Regulation A demonstrates that even today, equity and the public interest require consideration of "the totality of circumstances." (See Laporte Tr. 180:12-19.)

1. The "facts and circumstances" historically considered under Regulation A.

Neither the Commission nor any court has delineated all of the "circumstances" or factors (extenuating and aggravating) that are appropriately considered in Regulation A suspension hearings (including the cases cited above).[51] The cases above, and many others where a permanent suspension *was* issued, demonstrate the types of facts and circumstances that historically have been considered. Not surprisingly, these facts and circumstances are similar to those in *Gateway* and *Steadman* (discussed in more detail *infra*). The relevant factors historically considered by the Commission in suspension hearings are set forth below, with the commensurate facts as developed during the hearing in this matter following each factor:

- **Serious nature of offense - intent/scienter/willfulness**[52]

  Although the failure to file any report is serious, all investors had the primary offering document, the offering circular, prior to investing. That document was qualified by the SEC and contains a wealth of information about the offering. (See pp. 9-10, ¶ ¶ 9, 12, *supra.*) This was not an intentional or willful failure to file. (See pp. 13-14, ¶ ¶ 19-20, *supra.*)

- **Inadvertence in failing to file a report**[53]

---

[51] The ameliorating factors considered in analogous registration revocation cases (as opposed to Regulation A cases) are set forth at pages 39-45 below in the discussion of *Gateway, Steadman* and *E-Smart Technologies*. They are equally applicable to the issues here.

[52] *In the Matter of Mid-Hudson Natural Gas Corp*, SEC Release No. 33-3985, 1958 WL 55561(mistatement was not of such "serious nature" as to require suspension made permanent); *In the Matter of Telescript-CSP, Inc.*, SEC Release No.33-4644, 1963 WL 62765 (deficiencies are not of such nature to require a permanent suspension).

[53] *Washington Institute for Experimental Medicine, Inc.*, SEC Release No. 3822, 1957 WL 7721; *Simplex Precast Industries, Inc.*, SEC Release No. 33-3850, 1957 WL 7748; *British Industries Corporation*, SEC Release No. 33-3787, 1957 WL 7686.

The failure to file was wholly inadvertent, and was caused by an erroneous reading of the new statute by experienced outside counsel. (See pp. 13-14, ¶ 19, *supra.*) No precedent or guidance existed as to how the timing should work when there are multiple qualifications including amended offering statements before any shares are sold.

- **Fixing the filing deficiency**[54]

  Med-X prepared and filed the delinquent report 18 days (11 business days) after receiving notice of the violation. Meanwhile, the SEC estimates that preparing the report will require [600] hours. Outside counsel spent 90% of his time during this period working on the required reports. (See p. 15, ¶ 23, *supra.*)

- **Basis for the suspension still exists**[55]

  There is no basis to continue the suspension – Med-X quickly filed the required report (as well as a semi-annual report that was not yet due). (See p. 15, ¶ 23, *supra.*) Now that the issue regarding the initial annual report has been resolved, there are no questions as to when subsequent reports are due.

- **Failure to cooperate**[56]

  Med-X cooperated completely with the Commission. Upon receiving notice of the delinquency its lawyer immediately responded to the Commission, acknowledging the error and indicating the filing would be made. (See pp. 14-15, ¶ 22, *supra.*) Thereafter, Med-X promptly made the required filing and throughout these proceedings, has accepted responsibility for its error as to the filing and sales of shares while the report was unknowingly late. (See p. 15, ¶ 23, *supra.*) There are no allegations whatsoever that Med-X was uncooperative with the Commission during any phase of this offering or the post-notice proceedings. In fact, Med-X voluntarily turned over all shareholder information to the Commission. (Reilly Tr. 144:7-145:1.)

- **Good faith / sincere effort to comply/ consider other filings**[57]

---

[54] *Russell Janney, General Partner of Frontier Company,* SEC Release No. 33-4485, 1962 WL 69477; *Amish Company,* SEC Release No. 33-4944, 1958 WL 6450.

[55] *In the Matter of American Mining & Smelting, Inc.* SEC Release No. 3622, 1956 WL 7176.

[56] *In the Matter of Berkley Land and Investment Corporation,* Administrative Proceeding File No 3-4837, David J. Makun (1976); *In the Matter of Emer-Go Corporation,* Administrative Proceeding File No 3-5273, Irving Sommer (1978); *In the Matter of Sydnor-Barrett Scanner Corporation* Administrative Proceeding File No. 3-3319, David J. Markun (1972).

[57] *In the Matter of Lewis Securities Company,* Administrative Proceeding File No. 3-2259, Sidney L Feiler (1970); *In the Matter of Illowata Oil Company* SEC Release No.33-3999;1958 WL 55565.

But for the late annual report, Med-X was diligent in complying with all rules and requirements. Its initial offering statement was so thorough it received only one comment from the SEC, which was immediately addressed, before being qualified. (See p. 10, ¶ 10; p. 14 ¶ 20, *supra.*) Although the cash-strapped Med-X could have immediately begun offering and selling shares under Regulation A, it waited to do so until the last of three post-qualification amendments (addressing changes to the distribution plan) was itself qualified. (See p. 11, ¶ 13, *supra.*) Thereafter, Med-X filed additional amendments addressing the period within which it intended to offer shares. (See p. 12 ¶ 16, *supra.*) Testimony indicates that but for the one error, Med-X was extremely careful in meeting its filing requirements. (See p. 10, ¶ 10, *supra.*) At the time Med-X received notice of the late annual report it was already working on the required semi-annual report, which was filed ahead of schedule. (See p. 12, ¶ 17, *supra.*)

- **Public interest / protection of investors**[58]

There is *no* evidence supporting a "public interest" in punitively suspending Med-X for a one-time error in interpreting a new statute. The Division of Enforcement was armed with information as to all shareholders yet has presented no evidence of any investor complaints nor any indication that investors would have acted differently had the annual report been timely filed. Likewise, the Division of Enforcement has offered no evidence of material misrepresentations or omissions by Med-X.

Med-X has already been severely punished for its admitted mistake – it has been prevented from completing approximately 94% of its Regulation A offering, investors are reluctant to stay with the company as it operates under the cloud of this SEC proceeding, and it has incurred significant defense costs. (See p. 16, ¶ 26, *supra.*)

Conversely, there *is* a public interest in helping small companies such as Med-X raise capital under Regulation A, and not "chilling" the use of Regulation A because even a one-time filing error accompanied by the sale of a single share of stock could result in a permanent suspension of Regulation A *and* disqualification from other exemptions to registration like Regulation D. (See p. 17, ¶ 28, *supra;* Laporte Tr. 171:3-19; 192:1-20; RESP. Ex. I, ¶ 11.)

Mr. Laporte testified that if a permanent suspension is issued, Med-X's "options go way down," and if Med-X is "precluded from using the [Reg A capital-raising] means that are designed for this type of company, *it's pretty catastrophic."* (See p. 17, ¶ 30, *supra*; Laporte Tr. 225:20-226:11.)

---

[58] *Red Lane Calcareous Sinter Co., Inc.*, Release No. 33-4337, 1961 WL 61566; *Blue Haven Pools*, SEC Release No. 33-4668, 1964 WL 68235.

There *is* a public interest in calibrating a penalty to a violation, and avoiding an overly harsh penalty that could irreparably harm not only the company, but also its thousands of current shareholders. (E.g., Laporte Tr. 193:25-194:19; see generally 185:5-187:6.)

Mr Laporte's testimony is unrebutted: A permanent suspension "could be a disaster for the company, especially if they were a company that was – for whom Regulation A was tailored. (Laporte Tr. 193:25-194:19.) And the discretion accorded this Court "should be exercised to protect not only *potential* investors (who may benefit from timely periodic filings), but also *actual* investors in Med-X, who could be significantly harmed if there is a permanent suspension for an untimely filing." (RESP. Ex. I at 9.)

- **No further reason to believe the problem will reoccur and the company has urgent need for funds**[59]

  This was an inadvertent error by outside counsel – his first in thirty-eight years as a securities practitioner. (See p. 14, ¶ 20, *supra.*) No other filings were delinquent nor did they require substantial modifications before being qualified by the SEC. (See p. 10, ¶ 10, *supra.*) There is no reason to believe the problem will reoccur. Meanwhile, Med-X has an urgent need to raise funds from investors (without being hamstrung by limitations on "accredited investors" imposed under Regulation D). (See Mills Tr. 288:23-289:6; 296:25-297:12.)

  Without being able to complete its Regulation A offering, Med-X may not survive in its highly competitive, fast-growing industry. (See pp. 16-18, ¶ ¶ 26, 27, 30, *supra.*)

- **Number and nature of deficiencies**[60]

  The late report and sale of shares (when the company was unaware that the report was late) is Med-X's first deficiency. That deficiency was quickly corrected. (See pp. 14-15, ¶ ¶ 20, 23, *supra.*)

Of course, the totality of the so-called "aggravating factors" presented by the Commission at hearing must also be considered. They are:

- Med-X sold shares during the period the annual report was (unknowingly) delinquent (1.6% of the anticipated $15 million offering before the temporary suspension was issued), resulting in a potential violation of Section 5.

---

59 *Alaska Gulf Oil & Gas Development, Inc.*, SEC Release No 3545, 1955 LEXIS 34.

60 *Berkley Land, supra.*; *Sydnor-Barrett Scanner Corporation, supra.*

It is difficult to assess how, from an equitable perspective, this is "aggravating" conduct. One naturally would assume that stock is being sold during the offering, so the fact that shares were sold when the report was missing does not, itself, suggest *compounding* conduct. (See Laporte Tr. 181:20-25.) Mr. Laporte testified that a violation of Section 5 is not "a sufficiently aggravating circumstance" to justify a permanent suspension. (Laporte Tr. 212:12-213:10.) Mr. Laporte also testified that in his experience, there is nothing about Rule 258 as interpreted by the SEC that requires a permanent suspension if shares are sold while a periodic filing is late. (Laporte Tr. 183:13-17.)

This Regulation A precedent is consistent with the permissive language of Rule 258, and confirms that this Court has the discretionary power to consider public interest factors, and all extenuating (and aggravating) facts and circumstances to determine whether to vacate a temporary suspension despite an inadvertent failure to file and the sale of stock during the delinquency. Nothing in Rule 258 strips this Court of that discretion and mandates, as the Division of Enforcement insists, strict liability and an automatic permanent suspension from the exemption for a single late filing and, during that period, the sale of a single share of stock.

When all of the extenuating circumstances and good faith factors in this matter are compared to the aggravating factors raised by the Division of Enforcement, and in light of the Commission's precedent on such matters, coupled with the unrebutted testimony of Mr. Laporte, it is evident that the appropriate remedy here is to deny the Enforcement Division's request for a permanent suspension and instead vacate the Med-X temporary suspension.

D. Analogous cases addressing important filing requirements under the securities laws similarly consider relevant facts and circumstances in fashioning a remedy for violations.

At the conclusion of the hearing in this matter, the Court invited the parties to include what they considered to be analogous scenarios under the Act. As discussed by Mr. Laporte, the Commission's response to violations of other periodic reporting requirements under the securities laws is instructive. (E.g., Laporte Tr. 171:20-173:4, 173:18-174:15, 175:22-180:6; RESP. Ex. I, ¶ ¶ 8-9.) In those analogous cases the Commission has recognized that even when an important filing is missed and the securities laws are violated, there is a public interest component to fashioning an appropriate remedy, and that interest as well as equity requires consideration of the relevant facts and circumstances surrounding the violation. In the context of reporting violations under the Exchange Act, the relevant factors have become known as the *Gateway* factors, and they track those historically considered under Regulation A as set forth above. These factors are appropriately applied here, also in the context of a reporting violation, to determine whether a permanent suspension should be imposed. The common sense application of those factors strongly disfavors a permanent suspension and instead supports vacating the temporary suspension.

1. Annual and quarterly reports for registered companies.

Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 require public corporations to file annual and quarterly reports with the Commission. The reporting requirements are hugely important – they are the primary tool that Congress fashioned for the protection of investors from negligent, careless, and deliberate misrepresentations in

the sale of securities.[61] Compliance with these reporting requirements is mandatory, and scienter is not required to establish a violation.[62]

Under Exchange Act Section 12(j), the Commission is authorized, "as it deems necessary or appropriate for the protection of investors," to revoke the registration of a security or suspend for a period not exceeding twelve months if it finds, after notice and an opportunity for hearing, that the issuer of the security has failed to comply with any provision of the Exchange Act or rules thereunder, including the filing requirements. 15 U.S.C. §78*l*(j). Thus, the Commission and the courts have discretion, despite a registered company violating the Exchange Act's critical reporting requirements, to decide whether or not to revoke or suspend an issuer's registration.

This is a pragmatic and equitable approach: there are thousands of missed and late-filed reports each year, and despite their importance to investors, not every issuer deserves in equity to have its registration suspended or revoked for violating these requirements.[63] Although the reporting rules for registered companies are mandatory and shares are regularly sold without such reports on file, nothing in the Exchange Act or otherwise *mandates* automatic, strict-liability revocation for such late filers.

Rather than any "one-size-fits all" strict liability, the Commission and courts have developed a series of factors to help determine whether, *under the particular facts and circumstances of a case*, a serious sanction like a revocation of a registration is

---

[61] E.g., *SEC v. Beisinger Indus. Corp.*, 552 F.2d 15, 18 (1st Cir. 1977) (addressing a company's failure to timely file a 10-K).

[62] E.g., *America's Sports Voice, Inc.*, Exchange Act Release No. 55511, 2007 SEC LEXIS 1241, at *12 (Mar. 22, 2007), recons. denied, Exchange Act Release No. 55867, 2007 SEC LEXIS 1239 (June 6, 2007); *SEC v. McNulty*, 137 F.3d 732, 740-41 (2d Cir. 1998).

[63] In one study of reporting companies from 2000-2008, of 49,233 annual and quarter reports that were filed, 4,656 of these were first-time late filers. Bartov, Eli and DeFond, Mark L. and Konchitchki, Yaniv, *The Consequences of Untimely Quarterly and Annual Financial Reporting* (October 1, 2013). Available at SSRN: https://ssrn.com/abstract=2368413 or http://dx.doi.org/10.2139/ssrn.2368413.

appropriate and in the public interest.[64] These factors are generally referred to as the "*Gateway* factors," and they were developed in a case where the issue to be decided was whether a company's conduct in failing to make required filings was, *in light of the relevant facts and circumstances,* sufficiently egregious to support the serious sanction of a revocation.[65]

Gateway represented "the first litigated appeal in which [the Commission] must decide what sanctions are appropriate under Exchange Act Section 12(j) when an issuer has violated Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder by failing to make the required filings." (Id. at 9.) In *Gateway,* the company admitted it had failed to file seven annual and quarterly reports required under Section 13(a) and Rules 13a-1 and 13a-13. (Id. at 9.) After receiving notice from the SEC that it intended to initiate enforcement proceedings in connection with the missing reports, the company took no action to address the delinquent reporting status or to stay current with its ongoing reporting obligations. (Id. at 4.) During the time that Gateway was out of compliance it pursued an aggressive growth strategy, acquiring seven wholly owned subsidiaries, primarily in exchange for its common stock. (Id. at 5 n.11.) When the company belatedly made certain periodic filings, those reports contained misrepresentations about the SEC's enforcement action and the company's relationship

---

[64] Although a failure to file required reports is a serious issue, revocation of a Section 12(g) registration is virtually unheard of, absent the presence of other aggravating factors. (Laporte Tr. 178:5-12.) See *Scanner Technologies Corp.*, Initial Decisions Rel. No. 1059, 2016 SEC LEXIS 2822 (Sept. 14, 2016)(Revocation of registration is an appropriate sanction for repeated failures to file periodic reports, failure to heed delinquency letters sent by the Division of Corporate Finance, failure to participate in administrative proceedings to address any efforts to remedy their past violations and failure to give assurances against future violations).

[65] *Gateway International Holdings, Inc.*, Securities Exchange Act Rel. No. 53907, 2006 SEC LEXIS 1288 (May 31, 2006).

with its former auditor. (Id. at 6.) Other elements of the filings that were made were determined by the SEC to be deficient. (Id. at 7-8.)

On these facts, the *Gateway* Commission set forth factors that had often been used to address filing violations (including, for example, Regulation A reporting violations as set forth at pages 32-35, supra).[66] stated:

> Our determination, in such proceedings, of what sanctions will ensure that investors will be adequately protected therefore turns on 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. In making this determination, we will consider, 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 future violations.[67]

Applying these factors, the Commission concluded that "Gateway's conduct with respect to its reporting obligations was serious, egregious, recurrent, and evidenced a high degree of culpability." (Id. at 10.) It knew of its reporting obligations, yet failed to file seven reports, despite being warned of possible enforcement proceedings. (Id.) And while Gateway disregarded its filing requirements, it pursued an aggressive growth strategy, acquiring seven companies primarily in exchange for its common stock. (Id. at 11.) Instead of current, audited information, investors were forced to rely on outdated information that was three years old. (Id.) The Company did not "offer credible assurances against future violations," and at the time of the decision had filing deficiencies that remained outstanding – including additional delinquent reports. (Id.

---

66 See also, e.g., *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979).

67 Id. at 10. In setting forth these factors, the Commission indicated it was "informed by the court's discussion in *Steadman*, but noted that the *Gateway* factors "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." In the present case, a permanent suspension of the Regulation A exemption could be "catastrophic" for Med-X (Laporte Tr. 226:9-11; Mills Tr. 296:11-12), and therefore is similar in degree to a revocation.

and n.30.) And Gateway did not accept responsibility for its failure to meet its reporting obligations. (Id. at 11.)

Under these facts and circumstances, the Commission concluded that a revocation would "further the protection of investors including both current and prospective investors." (Id. at 12.) In the present case, the conduct of Med-X is nothing close to that of Gateway. As set forth at pages 32-35, *supra*, Med-X was late in filing one report, not seven. And unlike Gateway (which ignored notices of possible enforcement proceedings for the delinquent reports), Med-X quickly acknowledged the Commission's notice of the delinquency and worked around the clock to remedy the violation. Even more importantly, Med-X (unlike Gateway) was unaware of its reporting violation at the time it sold shares. And, of course, Med-X (unlike Gateway) has consistently accepted responsibility for its violation. (E.g., RESP. Exs. G2, G3; Mills Tr. 293:12-20, 294:13-19; Richardson Tr. 281:3-282:2.)

Applying the *Gateway* factors here, as is appropriate (Laporte Tr. 178:13-180:19; RESP. Ex. I at ¶ 9), supports Respondent's position that a permanent suspension should be denied and the temporary suspension should be vacated. (See also the factors set forth at pages 32-35, *supra.)*

E-Smart Technologies,Inc.,[68] is also instructive. In that case (which preceded the Commission's decision in *Gateway*) periodic reports due under Section 13(a) of the Exchange Act were filed an average of 990 days late. After a public hearing the court issued an Initial Decision that found e-Smart had violated the periodic reporting

---

[68] Initial Decisions Rel. No. 272, 2005 SEC LEXIS 253 (February 3, 2005). E-Smart Technologies later reverted to its "egregious conduct" which was, in any event, appalling in its scope, and far removed from the single delayed filing here.

requirements of the Exchange Act and therefore, as a sanction, revoked the registration of its common stock. Following its review, the Commission remanded the proceeding to provide the court an opportunity to assess the sanction in light of the fact that e-Smart had remedied the late filings. On remand, the court reviewed the importance of periodic reporting requirements, stressing they "help ensure that the investing public receives current, accurate information concerning the operation and financial condition of the company."[69] It further noted that "The reporting requirements of the Exchange Act are the primary tool which Congress has fashioned for the protection of investors from negligent, careless, and deliberate misrepresentations in the sale of stock and securities."[70]

The court further noted that the Division believes revocation "continues to be the only appropriate sanction for e-Smart's repeated failure to comply with applicable periodic reporting requirements, even in light of the company's 'belated efforts' to bring itself into compliance."[71] "According to the Division, the public interest factors still weigh in favor of revocation, and even though e-Smart 'may have now satisfied' its filing obligations, this 'should not shield it from sanctions for its past reporting failures.'" (Id.) The court noted the Division's warning that 'lifting the sanction . . . would undermine the principal objective of the reporting requirements . . . [and to] hold otherwise would encourage noncompliance by issuers until they are actually faced with a revocation order and would be contrary to the interests of the investing public." Conversely, e-Smart argued that 'no punitive sanction is necessary to protect investors because each and every

---

69 Id. at *5 citing, e.g., *SEC v. Kalvax, Inc.*, 425 F. Supp. 310, 315-16 (S.D.N.Y. 1975).

70 Id. citing *SEC v. Beisinger Indus. Corp.*, 552 F.2d 15, 18 (1st Cir. 1977).

71 Initial Decisions Rel. No. 272, 2005 SEC LEXIS 253 (February 3, 2005).

periodic filing is now publicly available" and that imposing the sanction of revocation would be unprecedented and unwarranted, and would serve only to damage, and not protect, investors." (Id. at *6.)

Recognizing that the only issue was the appropriateness of the sanction (which was authorized under the Exchange Act), the court considered the public interest factors set forth in *Steadman v. SEC:*[72] (1) the egregiousness of respondent's actions, (2) the isolated or recurrent nature of the infraction, (3) the degree of scienter involved, (4) the sincerity of the respondent's assurances against future violations, (5) the respondent's recognition of the wrongful nature of its conduct, and (6) the likelihood of future violations.

Based on this analysis, and despite recognizing that the company's reporting violations were both "recurrent and egregious" (including being *four years* late in filing its annual report), and "deprived investors, as well as potential investors, of vital information regarding e-Smart's business operations and financial condition" (id.) the court concluded that "I find the likelihood of future violations absent and the need for a strong sanction no longer necessary." Therefore, the SEC's request for revocation of the registration of e-Smart's common stock was denied and the suspension of its registration was equally inappropriate. (Id. at *7.) The court stated: "The effect of any suspension . . . would be to harm investors, unfairly, rather than to serve any deterrent or remedial function now that the company has filed, albeit untimely, all its delinquent reports." (Id.)

This analysis applies here, although the conduct of Med-X was nothing close to that of e-Smart. Med-X was late with only *one* report, was unaware of the violation until

---

[72] 603 F.2d 1126, 1140 (5th Cir. 1979).

informed by the SEC, and then quickly remedied the mistake. There is no evidence it is likely to repeat the mistake, which resulted from an erroneous interpretation by counsel of the new filing requirement. Under these circumstances, a permanent suspension would be manifestly unjust.[73]

That these cases pertain to registered companies is of little moment. Mr. Laporte testified that the periodic filings for registered offerings were the "closest analog to the situation we're talking about here." (Laporte Tr. 174: 9-11.) He also testified that in his experience, the SEC always considers the facts and circumstances when addressing late filings (Laporte Tr. 185:16-23), and that the *Gateway* factors should be applied in a Rule 258 proceeding involving late filings because that is an "analogous circumstance." (Laporte Tr. 179; 15-21.) According to Laporte, a long-time SEC insider, when assessing such cases, the courts, "acting in equity," should consider "the totality of the circumstances." (Laporte Tr. 180:7-19.) And as discussed above, when deciding whether to permanently suspend an exemption for failure to file required periodic reports under Regulation A, the Commission's analysis often concluded with "under the circumstances" and examined "mitigating factors" – demonstrating the applicability of *Gateway*-type factors to all delinquent filing cases where a serious sanction like suspension or revocation requires resort to equity.[74]

---

[73] Applying the *Gateway* factors to cases involving late or missing filings is now commonplace. Indeed, this Court has issued over forty hearing decisions where the issuer failed to timely file periodic reports. Although it appears that all of these cases involved defaulting respondents, this Court nonetheless has considered the *Gateway*-type facts and circumstances in determining the appropriate remedy for the reporting violations. E.g., *In the Matter of Eden Energy Corp and Fifth Season International, Inc.* Release 811, File No. 3-16522 (June 11, 2015).

[74] Comparing Regulation A companies to registered companies is warranted because Regulation A filings are similar to those of registered companies in many aspects. Experts on exemptions such as J. William Hicks have long-considered Regulation A offerings to be similar to "mini-registrations." J. William Hicks, *Exempted Transactions under the Securities Act of 1933*, (2016) §6.2; Accord, 3A Harold

Given the similarities in the annual filing requirements for Regulation A+ and registered companies, the notion that Regulation A+ is considered a "mini-registration" and the common stated purpose for such periodic filings, logic and "common sense" dictate that Rule 258 proceedings such as this may appropriately apply precedent from Section 12(j) cases to fashion an appropriate remedy.[75]

E. A permanent suspension under these facts and circumstances would disproportionately harm Med-X and its existing investors.

A permanent suspension of Med-X's exemption under Rule 258 would have extremely serious and far-reaching consequences significantly disproportionate to the inadvertent misconduct. Suspending an issuer's Regulation A exemption under Rule 258 is an extremely serious sanction because, under SEC Securities Act Rules 262(a)(7) and 506(d)(1)(vii), the suspension results in "bad actor" disqualification of the issuer from relying on securities offering exemptions under both Regulation A and D for five years, absent a waiver from the Commission, making it very difficult for the issuer to engage in exempt offerings of securities to finance a growing business.[76] (Laporte Tr. 186:24-187:6.)

Bloomenthal, *Securities and Federal Corporate Law*, § 5.05[1] (1995) ("Regulation A, although technically and conceptually a conditional exemption from the registration requirements for many purposes is a less stringent form of registration for relatively small offerings."). Similarly, Mr. Laporte testified that a Regulation A offering is "like a mini public offering." (Laporte Tr. 194:13).

[75] Other provisions of the securities laws also provide guidance. For example, Mr. Laporte notes that with respect to stop order proceedings under Section 8(d) of the Securities Act, the stop order is not permanent, and once a registration statement is updated to reflect current information the stop order is dropped. (Laporte Tr. 174:16-176:12.) Similarly, once a delinquent Rule 257 report is filed, there is no reason for punitive measures against an issuer. (E.g., Laporte Tr. 175:22-176:12.)

[76] 17 C.F.R. § 230.262(a); and 17 C.F.R. § 230.506(d). A waiver from the SEC of this type is discretionary. (Laporte Tr. 226:12-227:6.) Asked by the Division of Enforcement whether he believes there could be " a new regime of inappropriate denials of waivers," Mr. Laporte responded: "Well, I wonder after being in this proceeding and the way that this company is being treated. I'm wondering whether we might be in a different regime." (Laporte Tr. 227:11-17.)

Allowing a one-time failure to comply with a periodic reporting requirement of Rule 257 that has been cured by the issuer to serve as the basis for an order of permanent suspension of the Regulation A exemption under Rule 258 would have a chilling effect on the use of Regulation A for small offerings by the growing companies it was designed to help. (Laporte Tr. 171:3-19, 192:1-20; RESP. Ex. I, ¶ 11.) Companies would not use Tier 2 of Regulation A for small offerings if technical, even accidental, noncompliance with its reporting provisions would result in bad actor disqualification under Regulations A and D and permanent suspension of the exemption after the violation has been cured.

As Mr. Laporte testified, if "a single inadvertent failure to file a required report results in a suspension of the exemption, people just won't use it, because it's like a gotcha rule, and we don't – the Commission isn't usually in the business of issuing gotcha rules for smaller companies." (Laporte Tr. 192:11-16.)

This "chilling effect" is particularly poignant in that of the approximately 140 issuers that filed to conduct a Regulation A+ offering, only 81 offerings seeking $1.5 billion have been qualified since 2015.[77] (RESP. Ex. I, ¶ 12.) And it appears only a small fraction of those companies actually have raised money: approximately $190 million.[78] A prevailing view in the industry is that although Regulation A+ has shown a lot of promise, it has not been as widely embraced as had been hoped, largely because of the burdens imposed by Tier 2 ongoing reporting.[79]

---

[77] Anzhela Knyazeva, "Regulation A+: What Do We Know So Far?" Securities and Exchange Commission, 2016, p. 1; and 2016 Small Business Forum, Remarks of Keith Higgins, at 17:00, *available at* https://www.sec.gov/video/webcast-archive-player.shtml?document_id=gbforum111716.

[78] "Regulation A+: What Do We Know So Far?" p. 1.

[79] 2016 Small Business Forum, Remarks of Ryan Feit, at 1:11:30 ("A lot of companies are getting caught up on audited financials and on-going reporting"). Recommends modifying Tier 2 reporting obligations so that companies that are not being listed on exchanges do not have on-going reporting

If Rule 258 is misapplied so that permanently suspending companies from the exemption as a result of a late filing becomes the order of the day, the stated intent of the JOBS Act to foster increased access to capital by small businesses (and more investment opportunities for their investors) will be stymied, as few companies are likely to risk a "bad actor" designation and its potentially ruinous consequences (blocking access to capital under Regulations A and D) as a penalty for an inadvertent delay in making a filing. (Laporte Tr. 192:11-20; 225:20-226:17.)

A permanent suspension from the exemption also is misguided when a late filing has been corrected because it potentially harms those investors who have provided capital to the company.[80] (Laporte Tr. 193:25-194:21; RESP. Ex. I, ¶ 13.) If a late filing virtually automatically triggers "bad actor" disqualification, and the company is limited in the ways it can raise capital, people who have already invested in an offering under the exemption may see their investment devalued as the company struggles to raise money as a "bad actor" (a misnomer for an inadvertent late filer). (RESP. Ex. I, ¶ 13; see Laporte Tr. 225:20-226:11.) In this way, the investors as to whom the JOBS Act encourages participation could themselves be unnecessarily harmed. This is entirely inconsistent with the regulatory scheme of Regulation A+, and the discretion accorded regulators and this Court should be exercised to protect not only *potential* investors (who may benefit from timely periodic filings), but also *actual* investors in Med-X, who could be significantly

---

obligations. See also id. Remarks by Commissioner Kara M. Stein ("By some accounts the new capital raising options have not been widely adopted.").

80 E.g., E-Smart Technologies, Initial Decisions Rel. No. 272, 2005 SEC LEXIS 253 (February 3, 2005). ("The effect of any suspension, as with revocation, would be to harm investors, unfairly, rather than to serve any deterrent or remedial function *now that the company has filed, albeit untimely, all its delinquent reports.*" Emphasis added.).

harmed if there is a permanent suspension for an untimely filing. (See Laporte Tr. 171:3-19; Mills Tr. 296:20-297:12.)

CONCLUSION

For the foregoing reasons, Med-X respectfully submits that the Court should consider the facts and circumstances of this case and (i) deny the Division of Enforcement's request for a permanent suspension of the exemption under Regulation A and (ii) grant Med-X's request to vacate the temporary order suspending the exemption.

Dated: March 21, 2017

Respectfully submitted,

___/s/_____

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

Counsel for Respondent Med-X, Inc.

CERTIFICATE OF SERVICE

I hereby certify that true copies of the foregoing document were served on the following, this 21st day of March 2017, in the manner indicated below:

By email:

The Honorable Jason S. Patil
Administrative Law Judge
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-2557
ALJ@sec.gov

Kevin O'Rourke
Assistant Chief Litigation Counsel
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-4010
ORourkeK@sec.gov

Nancy Singer
Division of Enforcement
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-4010
SingerN@sec.gov

Joshua E. Braunstein
Counsel for Division of Enforcement
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-4010
BraunsteinJ@sec.gov

By Facsimile and First Class Mail:

United States Securities and Exchange Commission
Office of the Secretary c/o Ms. Melissa Kimps
100 F Street NE
Mail Stop 1090
Washington, DC 20549
Facsimile: 703-813-9793

James F. Moyle