UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17104

In the Matter of

BioElectronics Corp.,
IBEX, LLC,
St. John's, LLC,
Andrew J. Whelan,
Kelly A. Whelan, CPA, and
Robert P. Bedwell, CPA,

Respondents.

DIVISION OF ENFORCEMENT'S REPLY MEMORANDUM OF LAW IN RESPONSE TO RESPONDENTS' SUPPLEMENTAL BRIEF IN SUPPORT OF PETITION FOR REVIEW

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June 11, 2018

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INTRODUCTION

The Division of Enforcement ("Division") respectfully submits this reply memorandum of law in response to the supplemental brief submitted by Respondents BioElectronics Corporation ("BioElectronics" or "BIEL"), IBEX, LLC, St. John's, LLC, Andrew J. Whelan, and Kelly A. Whelan (collectively, "Respondents") on May 24, 2018 in support of their petition for review ("Br."). Respondents' Petition has been extensively briefed and is ripe for decision.[1] Despite the Commission's instruction that "[i]t is unnecessary to restate arguments asserted in previous briefing before the Commission,"[2] the vast majority of Respondents' brief does just that. With respect to these arguments, the Division rests on its prior submissions to the Commission, which establish that, on de novo review, the Commission should find Respondents liable for violations of Section 5 of the Securities Act of 1933 and Section 13 of the Securities Exchange Act of 1934, and impose the injunctive relief, disgorgement, and civil money penalties sought by the Division.[3] Nor do Respondents' challenges to the constitutionality of the ALJ's appointment and the appropriate relief under *Kokesh v. SEC*, 137 S. Ct. 1635 (2017)—which the ALJ fully considered in his Ratification Order[4]—change the necessary outcome of this case. The Commission should find Respondents liable for violations of Section 5 of the Securities Act of

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[1] Division's Response to Respondents' Supplemental Petition for Review (Mar. 15, 2018).

[2] Supplemental Briefing Order, Securities Act Release No. 10490, Exchange Act Release No. 83124 (Apr. 27, 2018).

[3] Division's Amended Opposition to Respondents' Brief in Support of Appeal to the Commission (May 8, 2017) ("Opp."); Division's Supplemental Submission in Support of Division's Opposition (June 16, 2017) ("*Kokesh* Br."). Citations to relevant portions of prior briefing are set forth in the attached Addendum.

[4] Order Ratifying in Part and Revising in Part Prior Actions, Admin. Release No. 5591 (Feb. 14, 2018) ("Ratification Order").

1933 and Section 13 of the Securities Exchange Act of 1934, and impose the injunctive relief, disgorgement, and civil money penalties sought by the Division.

ARGUMENT

A. The Commission's Ratification Order And The ALJ's Ratification Decisions Are Valid

In its November 30 Order, the Commission properly "ratifie[d] the agency's prior appointment" of its ALJs.[5] Ratification allows for the "adoption and affirmance by one person of an act which another, without authority, has previously assumed to do for him." 1 Floyd R. Mechem, *A Treatise on the Law of Agency* §347 (2d ed. 1914); *Black's Law Dictionary* (10th ed. 2014) (ratification renders an act "valid from the moment it was done"). The "ratification of an unauthorized act is deemed to be equivalent to a prior authority to perform it." Floyd R. Mechem, *A Treatise on the Law of Public Offices and Officers* §545 (1890). A ratification "may be inferred" from the parties' conduct, 1 *A Treatise on the Law of Agency*, §430, and may be "written or unwritten, express or implied," *A Treatise on the Law of Public Offices and Officers*, §§545, 547.

Two factors are critical in determining whether a principal has validly ratified an agent's previously unauthorized act. First, the principal must have had the authority to perform the act, both when the agent undertook it and at the time of ratification. *See* 1 *A Treatise on the Law of Agency*, §§347, 354, 374; *FEC v. NRA Political Victory Fund*, 513 U.S. 88, 98 (1994); *United States v. Heinszen & Co.*, 206 U.S. 370, 382 (1907); *Restatement (Third) of Agency* §4.04(1) & cmt. b (2006). Second, the conduct of the principal must lead a third party to "reasonably . . . conclude that the act of another in [the principal's] behalf has been adopted and sanctioned" by the principal. Floyd R. Mechem, *A Treatise on the Law of Agency* §146 (1888).

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[5] Pending Admin. Proc., Securities Act Release No. 10440, 2017 SEC LEXIS 3724, https://www.sec.gov/ litigation/opinions/2017/33-10440.pdf (Nov. 30, 2017) ("Order").

Those factors are satisfied here. Both at the time of the initial appointment and when it issued its Order, the Commission was authorized to appoint its ALJs. *See* 5 U.S.C. §3105 (agencies "shall appoint as many administrative law judges as are necessary"); *Free Enter. Fund v. Public Co. Accounting Oversight Bd.*, 561 U.S. 477, 512-13 (2010) (Commission is a Head of Department empowered to appoint inferior officers.). The Commission indisputably could have made the initial appointments itself, and it is beyond doubt that it can, and has, "adopted and sanctioned" those actions when it "ratifie[d] the agency's prior appointment" of its ALJs.

Courts have uniformly endorsed ratification in analogous circumstances. In *Edmond v. United States*, 520 U.S. 651 (1997), petitioners sought to overturn convictions that had been affirmed by military judges whose appointments had been deemed invalid in an earlier decision. The Supreme Court rejected petitioners' challenge, because an appropriate official had cured the constitutional error by "adopting" the judges' appointments "as judicial appointments of [his] own" before the judges had affirmed the convictions. *Id.* at 654, 666.[6] Other courts likewise have upheld ratifications following Appointments Clause and other constitutional challenges. *E.g.*, *CFPB v. Gordon*, 819 F.3d 1179, 1190-92 (9th Cir. 2016), *cert. denied*, 137 S. Ct. 2291 (2017); *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 796 F.3d 111, 115-16, 118-19 (D.C. Cir. 2015); *Doolin Sec. Sav. Bank, F.S.B. v. Office of Thrift Supervision*, 139 F.3d 203, 212-14 (D.C. Cir. 1998); *FEC v. Legi-Tech, Inc.*, 75 F.3d 704, 709 (D.C. Cir. 1996).

Respondents attempt to distinguish this line of authority by arguing that the Commission's ratification of ALJ Elliot's appointment was invalid because he was "hired," not "appointed." Br. 9. "Ratification," Respondents claim, "might cure a defective appointment, but

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[6] Respondents emphasize that, "[i]n *Edmond*, the underlying judge's rulings occurred **AFTER** the lawful appointment of those judges by the Secretary of Transportation," Br. 8 (emphasis in original), but the same is true here. The ALJ's decision to ratify occurred after the Commission issued its Order.

it cannot manufacture an appointment that never occurred." *Id.* at 8. To the extent that Respondents' argument hinges on the supposed difference between the terms "hire" and "appoint," it is baseless. The Commission decides whether to hire an ALJ, and that hiring, by statute, is referred to as an "appointment." *See* 5 U.S.C. §3105 (agencies "shall appoint as many administrative law judges as are necessary"); *id.* §3318(a) ("The nominating or appointing authority shall select for appointment to each vacancy from the highest three eligibles available for appointment on the certificate furnished under section 3317(a) of this title, unless objection to one or more of the individuals certified is made to, and sustained by, the Office of Personnel Management for proper and adequate reason under regulations prescribed by the Office."). The Commission thus did not "conflate[] the actions of hiring and appointment," Br. 5, because they are one and the same. And, to the extent Respondents argue that the ALJs' initial hirings cannot be considered "appointments" because they were not made by appropriate officials under the Appointments Clause, that argument would render ratification a nullity. In its Order, the Commission ratified and adopted those initial appointments—which undoubtedly did occur even if they were not done in a manner prescribed by the Appointments Clause—as its own. Nothing more is required.

Respondents' attempt to distinguish between hiring and appointment also ignores the Commission's stated purpose in the Order. The Order intended "[t]o put to rest any claim that administrative proceedings pending before, or presided over by, Commission administrative law judges violate the Appointments Clause." Order at 1. That clear statement of Commission intent undermines Respondents' effort to dispute particular words the Commission used in the Order. As a leading historical treatise explains, "[t]he methods by which a ratification may be effected are as numerous and as various as the complex dealings of human life," and "[i]t is impossible to

state them all." *A Treatise on the Law of Public Offices and Officers*, *supra*, §547. There can be no serious question that the Commission intended to "adopt[] and sanction[]" the ALJs' prior ability to conduct hearings, issue initial decisions, and perform all the functions given to ALJs by statute and regulation. *A Treatise on the Law of Agency*, *supra*, §146. That should be the end of the matter.

Respondents' attacks on the procedure by which the ALJ ratified his earlier rulings likewise fail. Br. 4-9. For example, Respondents' claim that only a new hearing will remedy the constitutional infirmity, *id.* at 4, has been soundly rejected by courts upholding ratification decisions made after comparable reviews. *E.g., Intercollegiate Broadcasting System*, 796 F.3d at 118-19 (de novo record review sufficient for valid ratification; "new hearing" not required); *Advanced Disposal Servs. E., Inc. v. NLRB*, 820 F.3d 592, 602-03 (3d Cir. 2016) (ratification valid where action was taken with "full knowledge of the decision to be ratified" and reflected "a detached and considered affirmation of the earlier decision"). Respondents unpersuasively attempt to distinguish those cases by arguing that ALJ Elliot failed to make "a detached affirmation" when ratifying his earlier rulings. *Id.* at 6-7, 9. There is no support for that assertion. And courts routinely have upheld ratification decisions made after far less rigorous procedures. *E.g., Gordon*, 819 F.3d at 1186, 1192 (Director's "Notice of Ratification" simply "affirm[ed] and ratif[ied]" prior actions and the challenger offered no evidence that the Director failed to make a detached and considered judgment concerning matters he ratified); *Legi-Tech*, 75 F.3d at 709. Respondents' unsubstantiated assertion that ALJ Elliot had a "natural bias toward affirming his own prior rulings," Br. 6, cannot overcome the "presumption of regularity [that] attaches to the actions of Government agencies." *U.S. Postal Serv. v. Gregory*, 534 U.S. 1, 10 (2001). Respondents' theory would also negate ratification whenever an adjudicator is asked

to reexamine his or her own prior action. That is not the law. *E.g.*, *Gordon*, 819 F.3d at 1186 (Director's "Notice of Ratification" "affirm[ed] and ratif[ied]" his own prior actions).

B. Respondents' Arguments Under *Kokesh* Are Unavailing

In the Ratification Order, the ALJ considered the Supreme Court's decision in *Kokesh* and correctly found that the sole modification to the Initial Decision required by *Kokesh* was to reduce the disgorgement previously ordered jointly and severally against Respondents Andrew Whelan, Kelly Whelan, BioElectronics, and IBEX from $1,580,593 to $767,593.[7]

Relying on a post-hearing declaration of their expert, Brian Flood, Respondents argue that disgorgement should be no greater than $462,532. Br. 17. The ALJ previously held that "Flood's post-initial decision calculation is inconsistent with the stipulated aggregate proceeds."[8] Respondents offer the Commission no basis to credit evidence that directly contradicts the hearing record and has never been subject to cross-examination. The Commission should reject Respondents' argument.

Respondents further argue that the Commission should reduce the disgorgement award by the amount of interest earned on the debt, because "[l]awful interest is not ill-gotten gains." Br. 17-18. Respondents' argument that pre-judgment interest is improper after *Kokesh* is unsupportable as a matter of law. Congress has made clear that prejudgment interest on disgorgement awards is appropriate: It has afforded the Commission the ability to order disgorgement "including reasonable interest" in administrative and cease-and-desist proceedings. Exchange Act §§21B(e), 21C(e). The cases on which Respondents rely for the contrary conclusion construed provisions of New Jersey state law that (1) have no bearing here; and (2) in

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[7] Ratification Order 3-4, 5.

[8] Admin. Release No. 4522 (Jan. 13, 2017).

any event, cannot override the express congressional determination that prejudgment interest be available in administrative and cease-and-desist proceedings. Br. 18. The ALJ correctly held that accrued interest is not a cost of acquisition or a direct transaction cost that reduced IBEX's actual profit, and that it therefore is irrelevant to the question of disgorgement.[9]

Respondents also claim that "[a]ny disgorgement award . . . should be reduced by the 15% capital gains taxes paid," Br. 18, but Respondents are not entitled to a "modification of the disgorgement amount based upon taxes [paid]" on their ill-gotten gains. *In re Laurie Jones Canady*, Release No. 41250, 1999 WL 183600, at *10 (Apr. 5, 1999), *pet. denied*, 230 F.3d 362 (D.C. Cir. 2000). Respondents must seek from the Internal Revenue Service—not the Commission—any relief from the taxes they pay on ill-gotten gains they are ordered to disgorge. *Cf. SEC v. Koenig*, 532 F. Supp. 2d 987, 994 (N.D. Ill. 2007) ("We leave the tax consequences of this decision for Koenig to work out with the IRS."); 26 U.S.C. §6201(a) (Treasury Secretary is "authorized and required to make the inquiries, determinations, and assessments of all taxes . . . imposed by [the Tax Code].").

Respondents mistakenly urge that [t]he date of the Commission's Ratification Order, not the OIP, should govern the applicable 5-year statute of limitations. Br. 18. The Order Instituting Proceedings in this case was issued by the Commission within the statute of limitations. Because the constitutionality of the Commissioners' appointments is undisputed, the OIP was and remains valid regardless of any initial defect in the appointments of the Commission's ALJs.

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[9] Ratification Order 5.

C. The Disgorgement And Penalties Assessed By The ALJ Do Not Violate The Eighth Amendment

Respondents also argue that the disgorgement and penalties assessed in the Initial Decision, as ratified, are excessive under the Eighth Amendment. Br. 19-21. Respondents' reading of *Kokesh* is unsupportable, and their claims are factually baseless.

Even assuming that the ALJ's disgorgement order were subject to the Excessive Fines Clause—an issue *Kokesh* did not address, *see SEC v. Jammin Java Corp.*, No. 15-cv-08921, 2017 WL 4286180, at *2-4 (C.D. Cal. Sept. 14, 2017) ("*Kokesh* is best seen as a decision clarifying the statutory scope of [28 U.S.C.] § 2462, rather than one redefining the essential attributes of disgorgement"), *appeal docketed*, No. 17-56423 (9th Cir.)—a fine violates the Eighth Amendment only if it is "grossly disproportional" as compared to "the gravity of the defendant's offense." *United States v. Bajakajian*, 524 U.S. 321, 336-37 (1998). The disgorgement in this case—limited to the amount of gains resulting from Respondents' violations—was necessarily proportional to those violations. *SEC v. Metter*, 706 F. App'x 699 (2d Cir. 2017) (disgorgement not grossly disproportional because "it almost precisely equaled the gains from the illicit conduct" and was therefore "directly keyed to the scope of the wrongdoing"); *SEC v. O'Hagan*, 901 F. Supp. 1461, 1468-70 (D. Minn. 1995) (stating that properly ordered disgorgement "will always be proportional, or rationally-related, to a defendant's illegal profit").

Furthermore, Respondents' argument that the disgorgement and penalties assessed by the ALJ are excessive under the Eighth Amendment because they "caused no harm" is specious. As the Division proved at trial, Andrew Whelan and BioElectronics's Board of Directors were wholly unconcerned about the impact of their actions on the investing public. Respondents decided to fund BioElectronics's day-to-day operations through Section 5 violations at the

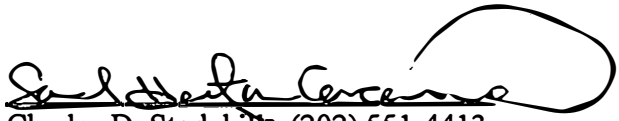
expense of BioElectronics's shareholders, who saw their stock value plummet with the dilution of BioElectronics stock.[10]

CONCLUSION

For the reasons set forth above and in the Division's prior submissions to the Commission, the Division respectfully requests that the Commission uphold the ALJ's Initial Decision, as ratified, and issue an order in favor of the Division and against Respondents.

Dated: June 11, 2018

Respectfully submitted,



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[10] Opp. 10-11, 35-37.

ADDENDUM

Argument	Respondents	Division	ALJ
Purported "errors" in Initial Decision	Br. 3 (Opening Br. 5)	Opp., *passim*	Initial Decision Release No. 1089 (Dec. 13, 2016), *passim* ("ID"); Ratification Order, *passim*
Factual Background	Br. 3 (Opening Br. 6-13; Respondent' Reply Br., Section A 1-5)	Opp. 4-13	ID 4-18
The ALJ's appointment complied with the Appointments Clause	Br. 4 (Opening Br. 13; Reply Br. 15)	Argument, *supra*, §A	Ratification Order 2-3
BioElectronics is liable for IBEX and St. John's sales, and BIEL's sales to IBEX and St. John's are not exempt under Section 4(a)(2)	Br. 15 (Opening Br. 14; Reply Br. 18-19)	Opp. 16-17	ID 39
IBEX's sales are not exempt under Section 4(a)(1), nor within Rule 144's safe harbor	Br. 15 (Opening Br. 14-15, 18-20; Reply Br. 14-18)	Opp. 17-25	ID 39-41, 42-48
IBEX cannot rely on Section 4(a)(1) because it is an affiliate of BIEL	Br. 15 (Opening Br. at 15-18)	Opp. 19-21	ID 2, 40-41, 42-47
IBEX cannot rely on Section 4(a)(1 ½) because these were not private transactions	Br. 15 (Reply Br. 16-18)	Opp. 15-17	ID 39
Section 4(a)(7) Exemption	Br. 15 (Opening Br. 21)	Opp. 25	ID 39
St. John's sales are not exempt under Section 4(a)(1), nor within Rule 144's safe harbor	Br. 15-16 (Opening Br. 21-23)	Opp. 25-26	ID 39-41
"Imperfect Compliance" with Rule 144 is not enough	Br. 16 (Opening Br. 23; Reply Br. 18)	Opp. 27	ID 39-41

Argument	Respondents	Division	ALJ
Like the ALJ, the Commission should reject arguments regarding alleged reliance on counsel	Br. 22-23 (Opening Br. 37-39; Reply Br. 19)	Opp. 39-42	ID 4, 53; Ratification Order 1
IBEX acquired BIEL securities with the intent of distributing them to the market, and did not intend to invest long-term	Br. 22	Opp. 5-7, 14-15, 18-19, 24-25	ID 42-44
Respondents have not established inability to pay	Br. 22 (Opening Br. 28-31)	Opp. 37-39	ID 57-59
Evidence supports disgorgement imposed by the Initial Decision	Br. 22 (Opening Br. 32-34)	Opp. 32-35; *Kokesh* Br. 2-6.	ID 54-57; Ratification Order 3-4, 5
Evidence supports civil monetary penalties imposed by the Initial Decision	Br. 22 (Opening Br. 35-37)	Opp. 35-37	ID 57-59
Injunctive relief afforded by the ALJ, including the permanent penny stock bar, is appropriate	Br. 23 (Reply Br. 20-21)	Opp. 30-32	ID 49-54, 57
The ALJ did not err in limiting character evidence	Br. 23 (Opening Br. 39-41; Reply Br. 13-14)	Opp. 42-43	ID 57-59; Ratification Order 1
The Commission should give no weight to expert opinions of Messrs. Cutler, Staelin, and Robinson	Br. 23 (Opening Br. 41-42)	Opp. 43-46	ID 31, 44, 47
BIEL improperly recognized revenue in violation of Section 13 and rules thereunder and its arguments that it withdrew its registration under Section 12(g) are unavailing	Br. 23 (Opening Br. 42-44)	Opp. 11-13, 27-30	ID 31-32
The ALJ properly excluded the post-hearing Declaration of Respondents' expert, Brian Flood	Br. 23 (Flood Declaration, ¶¶ 10-20; Reply Br. at 19)	Argument, *supra*, 6	Admin. Release No. 4522 at 2 (Jan. 13, 2017); Ratification Order 1

THE DIVISION OF ENFORCEMENT'S CERTIFICATE OF COMPLIANCE

I hereby certify, pursuant to the Commission's Supplemental Briefing Order of April 27, 2018 (Securities Act Release No. 10490; Exchange Act Release No. 83124), that the Division of Enforcement's Reply Memorandum of Law in Response to Respondents' Supplemental Brief in Support of Petition for Review was prepared using Microsoft Word. The word count for the Division of Enforcement's Reply Memorandum of Law, including the Addendum and excluding pages containing the Cover, Table of Contents, Table of Authorities, and Signature is 2,995 words.

Dated: June 11, 2018

Counsel for the Division of Enforcement

CERTIFICATE OF SERVICE

I hereby certify that true copies of the foregoing Division of Enforcement's Reply Memorandum of Law in Response to Respondents' Supplemental Brief in Support of Petition for Review were served on the following, this 11th day of June 2018, in the manner indicated below:

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