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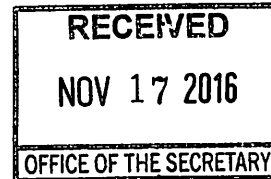
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16649



In the Matter of:

Ironridge Global Partners, LLC,
Ironridge Global IV, Ltd.

Respondents.

RESPONDENTS' REPLY IN SUPPORT OF MOTIONS IN LIMINE

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The crux of the Division's Opposition to Respondents' Motions in Limine is that the Commission may impose a $22 million sanction on Respondents without having first defined, either in the Commission's guidance or in the OIP, which of Global IV's attributes supposedly made Global IV a "dealer." The Court should reject that position and grant Respondents' motions in limine.

ARGUMENT

A. The Court Should Limit the Division's Proof to The Existing Dealer-Identifying Factors.

Respondents moved the Court to limit the Division's proof to evidence that Global IV had a traditional dealer's familiar attributes – i.e., attributes the Commission and others have listed repeatedly. *See, e.g.*, *Chapel Investments, Inc. v. Cherubim*, 177 F. Supp. 3d 981, 2016 WL 1552040, at *7 (N.D. Tex. 2016); *Oceana Capitol Grp. Ltd. v. Red Giant Entm't, Inc.*, 150 F. Supp. 3d 1219, 1226 (D. Nev. 2015) (citing the Guide to Broker-Dealer Registration).

In its Opposition, the Division argues that the Exchange Act defines a dealer "broad[ly]" to include everyone "engaged in the business of buying and selling securities," which apparently (in the Division's view) includes all businesses that focus on securities transactions. Opp. at 4-6; *see also* 15 U.S.C. § 78c(a)(5)(A). Based on that premise, the Division contends that it need not prove that Global IV had the well-recognized dealer attributes; instead, the Division argues that it may rely on any evidence that Global IV's business focused on securities transactions. That is how the Division justifies relying on evidence, for example, that Global IV sold "securities in the open market"; engaged in more than a "few isolated [securities] transactions"; or "advertised" Global IV's investment program. Motions at 2. The Court should reject that sweeping, novel, and incorrect position.

The Division's argument fails at the premise. The Commission, the Division of Trading and Markets, and courts have repeatedly rejected the position that the phrase, "engaged in the business of buying and selling securities" in § 78c(a)(5)(A), makes a dealer out of everyone whose business focuses on securities transactions. *E.g.*, *Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks under Section 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934* ("Proposed Dealer Exemption Rule"), Exchange Act Rel. No. 34-46745, 67 Fed. Reg. 67,496, 67,499 (Nov. 5, 2002); *SEC v. Federated Alliance Group, Inc.*, No. 93-0895, 1996 WL 484036, at *5 (S.D.N.Y. Aug. 21, 1996). Otherwise, the definition would be "excessively broad" and impose a dealer's regulatory burdens on everyone for whom investing is more than a hobby. *Federated Alliance*, 1996 WL 484036, at *5; *see generally* 15 DAVID A. LIPTON, BROKER-DEALER REGISTRATION § 1:3 (2015) (describing the consequences of registering as a dealer).

Instead, the Commission and other authorities have consistently understood the word "business" in § 78c(a)(5)(A) to be a term of art that refers to a traditional dealer's business. That business is chiefly market making, which means enhancing a security's "liquidity" by "continuously" holding oneself out as willing to "buy and sell" the security so that "an individual who [also] wishes to buy or sell the security" can simply transact with the dealer rather than "wait until [another ordinary investor is] found who wishes to take the opposite side in the desired transaction." *Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266, 267-68 (3d Cir. 1998); *In re Credit Default Swaps Antitrust Litig.*, No. 13-2476, 2014 WL 4379112, at *1 (S.D.N.Y. Sept. 4, 2014); *see also* 15 U.S.C. § 78c(a)(38).

For example, in 2002 the Commission discussed the "dealer" definition at length in a proposed rule. Proposed Dealer Exemption Rule, Exchange Act Rel. No. 34-46745, 67 Fed. Reg. 67,496, 67,499 (Nov. 5, 2002). The Commission directly addressed the meaning of the

"engaged in the business" language in a section titled "'Engaged in the Business' Test." *Id.* at 67,499. According to the Commission, "[a]s developed over the years" authorities have interpreted that phrase to encompass those with a traditional dealer's liquidity-enhancing business: For example, those who act as a market maker or a de facto market maker; buy and sell directly to securities customers; extend credit and lend securities in connection with securities transactions; have a regular clientele; hold themselves out as buying and selling securities at a regular place of business; have a regular turnover of business or participate in new issues; transact a "substantial portion of their business with investors"; and so on. *Id.* On the other hand, as significant here the Commission has said that the phrase does not encompass those with the business of a "trader," which is self-interested securities professional or firm (such as a hedge fund) that does not provide liquidity services and thus does not "handle others' money or securities, do[es] not make a market, and do[es] not furnish dealer-type services such as rendering investment advice, extending or arranging for credit, or lending securities." *Id.*; *see also* 15 U.S.C. § 78c(a)(5)(B); *Risks of Hedge Fund Operations, Hearing on Hedge Fund Operations Before H. Comm. on Banking*, 105th Cong. (1998) (testimony of Richard R. Lindsey, Dir., Div. of Mkt. Regulation, U.S. SEC), http://www.sec.gov/news/testimony/testarchive/1998/tsty1498.htm ("Lindsey Testimony") (noting that hedge funds "typically" do not register as dealers); *see also id.* ("[T]he Commission does not regulate the activities of hedge funds[.]"). This well-established distinction is significant in understanding the issues in this case.

In short, the Division here is incorrect that the phrase, "engaged in the business" in § 78c(a)(5)(A), transforms all securities professionals into dealers. It does not. The phrase instead refers to traditional, market-making dealers.

With that premise's defeat, the rest of the Division's argument collapses. Because the definition of "dealer" refers to traditional dealers only, the Division may prove its case here only by showing that Global IV has the specific, familiar attributes of a traditional dealer. Those familiar dealer attributes are the ones the Commission, Division of Trading and Markets, and courts have been repeating with little variation for *decades*:

- Making a market in securities;
- Holding itself out as willing to buy and sell a particular security on a continuous basis;
- Running a matched book of repurchase agreements;
- Issuing or originating securities that one also buys and sells;
- Advertising or otherwise letting others know that one is in the business of buying and selling securities;
- Doing business with the public directly;
- Quoting prices for both purchase and sale of a security;
- Participating in a "selling group" or otherwise underwrite securities;
- Providing services to investors, such as handling investors' money and securities, extending credit to investors, or giving investment advice to investors;
- Writing derivatives contracts that are securities.

E.g., "Who is a Dealer?," *Guide to Broker-Dealer Registration* (April 2008), https://www.sec.gov/divisions/marketreg/bdguide.htm; *Chapel* , 2016 WL 1552040, at *7; *Federated Alliance Group, Inc.*, 1996 WL 484036, at *4; Proposed Dealer Exemption Rule, 67 Fed. Reg. at 67,499; *Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Bank Under Sections 3(A)(4) and 3(A)(5) of the Securities Exchange Act of 1934* ("Final Dealer Exemption Rule"), 17 C.F.R. Part 240, 2003 WL 328058, at *4 (Feb. 13, 2003); *OTC Derivatives Dealers*, 63 F.R. 59362-01, 59,370 n.61 (Nov. 3, 1998); *Nat'l Council of Savings Insts.*, SEC No-Action Letter, 1986 WL 67129, at *1-2 (July 27, 1986);

Burton Securities, SEC No-Action Letter, 1977 WL 10680, at *1-2 (Dec. 5, 1977). Thus, the Court should limit the Division's proof to those factors.

The Division's only citation for its view that all securities firms are dealers is *SEC v. Big Apple Consulting USA, Inc.*, 783 F.3d 786 (11th Cir. 2015) ("*Big Apple*"). As an initial matter, the facts of that case are so unique that its holdings have little relevance in other cases about dealer registration. The defendants there were public-relations firms that promoted securities in a massive fraud scheme. *Id.* at 791, 792-94. To the extent the court held that the defendants were dealers that must register, the court did so to ensure that the SEC could monitor and snuff out such fraudulent behavior. The court did not hold that all law-abiding securities firms must register as dealers in all circumstances. To the contrary, as one authority recently recognized, after *Big Apple* dealers still do not include a "person who buys and sell securities for his own account in the capacity of a trader or individual investor." 1 BRENT A. OLSON, PUBLICLY TRADED CORPORATIONS HANDBOOK § 5:72 (2016).

More to the point, *Big Apple* is legally distinguishable because it addressed the "dealer" definition under the Securities Act, not the Exchange Act. 783 F.3d at 809-10. The Exchange Act's definition is narrower than the Securities Act's. For example, only the Exchange Act's definition excludes entities that qualify as "traders" under the multi-factor test identified above. *Compare* 15 U.S.C. § 77b(a)(12) *with* 15 U.S.C. § 78c(a)(5)(A)-(B). And the Securities Act, but not the Exchange Act, includes "broker[s]" in the definition of "dealer." *Compare* 15 U.S.C. § 77b(a)(12) *with* 15 U.S.C. §§ 78c(a)(4), (5). Thus, that Securities Act "dealers" might include all securities professionals (according to the Division's reading of *Big Apple*) does not mean that Exchange Act "dealers" do too.

In a short, conclusory footnote, the *Big Apple* Court did suggest that the Securities Act and Exchange Act "dealer" definitions are similar, apparently because both describe entities that

"engage" in the "business" of buying and selling securities. 783 F.3d at 809 n.11. The court was mistaken for two reasons. *First*, just because two statutes use similar terms with somewhat similar definitions does not mean that the terms have the same meaning in both. *See Envt'l Def. v. Duke Energy Corp*, 549 U.S. 561, 574-76 (2007). To the contrary, "Context counts." *Id.* at 576. The relevant context here is, again, that the Exchange Act definition is narrower, because it excludes traders and brokers. *Second*, to hold that everyone whose business is securities-centric is a dealer under the Exchange Act would, to repeat, create an "excessively broad definition of a dealer" that would dramatically extend the Exchange Act's burdensome regulatory requirements. *Federated Alliance*, 1996 WL 484036, at *5; *see generally* Lipton, *supra*, § 1:3 (describing the consequences of registering as a dealer). Indeed, the definition would "embrace as a dealer every securities trader who makes money through buying and selling of securities." *Federated Alliance*, 1996 WL 484036, at *5. Neither the *Big Apple* court nor the Division cites anything to show that Congress intended such an extraordinary result. The Division's citation is therefore unpersuasive.

Thus, the Court should limit the Division's proof to the factors the Commission, Division of Trading and Markets, and courts have adopted for confirming that a respondent has the familiar attributes of a traditional dealer. Because the Division cited nothing to show that its proliferating list of factors fits those criteria, the Court should limit the Division's proof to those factors listed on the "Who is a Dealer" guidance – the same guidance the Division's own expert relied upon. Lowry Report at 27-29 (Nov. 2, 2015).

B. The Court Should Limit the Division's Proof to the OIP's Allegations.

In addition to its request to introduce evidence on dealer-identifying factors absent from the long-standing guidance, the Division also asks to introduce evidence on factors beyond the three listed in the OIP. The Court should reject that request.

The Division argues that it may prove liability using "evidentiary data point[s]" not in the OIP. *In re Timbervest*, Admin. File No. 3-15519, 2015 WL 5472520, at *20 (June 8, 2015) (Commission opinion). That is true only to a degree, and not in a way that would help the Division here. The Division may not prove liability based on factual allegations that substantially expand or depart from what an OIP alleged. For example, the Division may not prove liability based on facts that occurred after the timeline alleged in an OIP. *In re E-Smart Tech., Inc.*, Admin File No. 3-10977, 2004 WL 407490, at *4, 5 (March 4, 2004) *remanded on other grounds by* 2004 WL 2309336 (Oct. 12, 2004). Likewise, the Division may not pursue a "broader theory of liability" than is in an OIP by attributing to a respondent conduct that the OIP attributed to others. *In re H.J. Meyers & Co., Inc.*, Admin. File No. 3-10140, 2002 WL 1828078, at *52 (Aug. 9, 2002), *aff'd* 2003 WL 22570689 (Nov. 7, 2003). And, particularly significant here, the Division may not charge a respondent for two accounting errors when the OIP charged the respondent with just one, even if the two "arise out of the same operative facts." *In re Philip L. Pascale, CPA*, Admin File No. 3-11104, 2004 WL 1103671, at *31 (May 17, 2004).

That rule defeats the Division's argument here. The Division would introduce more than a few "evidentiary data points" omitted from the OIP. The Division would prove an entirely new set of facts. The OIP – which the Division drafted after at least 20 months of preparation – listed just three reasons that Global IV was supposedly a dealer: (1) "engaging in serial underwriting activity"; (2) "providing related investment advice"; (3) and "receiving and selling billions of shares in connection with self-described financing services for domestic microcap companies . . . explicitly designed to utilize the registration exemption contained in Section 3(a)(10) of the Securities Act of 1933." OIP, ¶ 1. As Respondents explained in their Motions, the Division's list of reasons has since grown to at least 12. Motions at 2. The Court should reject the

Division's attempt to pursue such a "broader theory of liability." *H.J. Meyers*, 2002 WL 1828078, at *52

To defend its proliferating list, the Division argues that some of its new reasons for labeling Global IV a dealer were in the OIP – if one were to cobble together multiple paragraphs and read between the lines. For example, the Division cites 5 paragraphs that supposedly signaled the Division's intent to argue that Global IV is a dealer because Global IV supposedly resold securities in the open market (which is factually inaccurate). Opp. at 2 (citing OIP, ¶¶ 1, 24, 26, 27, 33). That argument fails. The multitude of paragraphs simply describe Global IV's general investment strategy as the Division understood it; those paragraphs do not purport to list additional reasons why Global IV was allegedly a dealer.

The Division also argues that Respondents have been "on notice for more than a year" about the Division's proliferating list of reasons why Global IV was allegedly a dealer. Opp. at 4. Sometimes the Division's post-OIP filings may indeed introduce new allegations that the Division may rely upon in a final hearing. But again, only to a degree, and not in any way that helps the Division here. The Division may not go "well beyond the scope of the OIP." *H.J. Meyers*, 2002 WL 1828078, at *52. That is precisely what the Division is attempting to do here.

The Court should limit the Division's proof to the OIP's three reasons for labeling Global IV a dealer.

C. The Court Should Exclude the Division's Supposed Dilution Evidence.

At the hearing the Division intends to submit supposed evidence that Global IV's investment strategy "diluted" companies' stock and reduced companies' stock prices. According to the Division, those assertions are relevant because they show (1) that Global IV harmed companies and investors, and (2) that requiring Global IV to register as a dealer would be

worthwhile, because as a dealer Global IV could not have engaged in such trades. That argument fails for two reasons.

First, the Division's supporting "evidence" is irrelevant because it so weak and misleading that it does not even *tend* to prove that Global IV harmed anyone. That "evidence" consists of Summary Exhibits 8 and 9 in the Division's expert report. Lowry Report at 16-17. In Summary Exhibit 8, Mr. Lowry purports to show that Global IV "diluted" companies' stock by using a chart stating (1) the number of shares the company had outstanding *before* Global IV acquired those shares in a § 3(a)(10) exchange, and (2) the total number of shares Global IV eventually sold. *Id.* at 16-17. In some instances, the latter exceeded the former, from which Mr. Lowry makes the unsupported leap that Global IV singlehandedly forced the company to issue large amounts of stock. But that analysis lacks a factual basis. In between Global IV's original acquisition and eventual sales, the issuing company could have flooded the market (and often did flood the market) with issuances to investors other than Global IV. If so, and if the shares Global IV eventually sold were small compared with the other issuances, then Global IV did not dilute the stock. The companies and other investors did. Lowry has made no effort to consider whether the issuing companies had flooded the market with additional shares after Global IV's acquisition of shares.

Exhibit 9 also does not support the Division's assertions. There, Mr. Lowry shows that some (but not all) companies' stock prices declined after Global IV acquired shares from them. Mr. Lowry then leaps to the conclusion, *ipsi dixit*, that Global IV must have caused the price decline. But Mr. Lowry does not take the elementary step of attempting to rule out other possible causes for the decline, such as that (1) the companies flooded the market with stock issuances to investors other than Global IV; (2) the companies were struggling even before Global IV's investment (hence their need to complete § 3(a)(10) exchanges in order to remove

debt from their books); or (3) market trends. Analysis so impoverished cannot support at all the Division's position that Global IV harmed the companies or the investing public. Such evidence is therefore irrelevant.

Second, the Division is wrong that requiring Global IV to register as a dealer would keep Global IV from engaging in the trading activity that, supposedly, caused stock dilution and price decline. The basis for the Division's assertion is again Mr. Lowry, who contends that as a registered dealer Global IV would have joined FINRA and thus been subject to FINRA compensation limitations in FINRA Rules 5110(c)(2)(a) and 5110(f)(2)(I). Lowry Report at 36-37. Mr. Lowry's analysis has many fatal defects, including (but by no means limited to):

- Even if Global IV did register as a dealer, Global IV would not necessarily be a FINRA member subject to FINRA regulations. Under SEC Rule 15b9-1, Global IV instead could join a national securities exchange. 17 C.F.R. § 240.15b9-1.

- The compensation limitations Mr. Lowry cites apply to compensation in "public offering[s]." FINRA Rules 5110(c)(2)(A), 5110(f)(2). Under FINRA Rule 5121(f)(11), a public offering is a "primary or secondary offering of securities made pursuant to a registration statement or offering circular[.]" Global IV engaged in no transactions "pursuant to a registration statement or offering circular."

- Likewise, the rules Mr. Lowry cites limit "underwriting" compensation. *E.g.* FINRA Rule 5510(c) ("Underwriting Compensation and Arrangements"). By selling stock Global IV acquired in § 3(a)(10) exchanges, Global IV did not act as an underwriter. SEC guidance says explicitly that securities "exempt under Section 3(a)(10) may generally be resold without regard to Rule 144" – which is a rule that identifies underwriters. Division of Corporate Finance, Staff Legal Bulletin No. 3A (June 18, 2008), *available at* https://www.sec.gov/interps/legal/cfslb3a.htm.

Alternatively, the Division contends that the Exhibits evidence Global IV's selling large volumes of securities , which the Division believes makes Global IV an underwriter. The evidence is still irrelevant, for at least two reasons. First, the evidence cannot make Global IV an underwriter. To repeat, under Staff Legal Bulletin No. 3A, one cannot be an underwriter for selling § 3(a)(10) securities. Second, the evidence cannot show that Global IV sold large volumes of securities: Whether Global IV traded in "large" volumes depends on whether those

trades were large compared to the percentage of total shares outstanding at the time of sale. As explained above, Summary Exhibits 8 and 9 omit the total shares outstanding at the time of sale.

In short, the Division's evidence is so deficient as to be irrelevant. To streamline the anticipated two-week hearing, the Court should exclude that evidence.

D. The Court Should Exclude the Banking Records.

In opposition to Respondents' motion to exclude banking records as irrelevant, the Division contends that such records are relevant for four reasons. The Division is wrong, and the evidence should be stricken.

First, according to the Division such records show that Respondents "used the proceeds from the sale of the stock to pay the debt claims" Respondents assumed in § 3(a)(10) exchanges and also that Respondents' individual principals "faced very little to no risk." But those supposed facts do not show that Global IV was a dealer, nor are they related to the Division's proposed sanctions in any way.

Second, according to the Division such records show that "Respondents paid finder and referral fees to third parties in connection with the 3(a)(10) transaction[s]." Opp. at 8. The Division insists that such fees' payment rebuts Global IV's assertion that, even if Global IV were a dealer, the Foreign Broker-Dealer rule would exempt Global IV from dealer registration. Presumably the Division means that paying such fees is a form of "solicitation" and that such solicitation makes Global IV ineligible for one of the rule's grounds for exemption. 17 C.F.R. § 240.15a-6(a)(1). But the Commission has not identified paying finder's fees as a kind of "solicitation" that would make a foreign dealer ineligible for the Foreign Broker-Dealer rule's exemptions. *Registration Requirements for Foreign Broker-Dealers* ("Foreign Broker Dealer Rule"), Exchange Act Rel. No. 105, 54 Fed. Reg. 30013-01, at *299-300 (July 11, 1989). Even if the Commission had, the Division cites no evidence that Global IV itself (as opposed to

Partners) is the one that paid the alleged fees and thus no evidence that Global IV itself solicited anyone. Absent evidence that Global IV engaged in solicitation, Global IV is exempt from registration under the rule.

Third, and relatedly, the Division contends that Respondents' paying finders fees distinguishes Global IV from Acqua Wellington North American Equities Fund, Ltd., a self-described underwriter that SEC guidance says was not a dealer. *Acqua Wellington North American Equities Fund, Ltd.*, SEC No-Action Letter, 2001 WL 1230266 (Oct. 11, 2001). But that evidence exposes a distinction without a relevant difference between Global IV and Acqua Wellington. Whether one pays finder's fees is not a factor for identifying a dealer. *See, e.g.*, "Who is a Dealer?," *supra*.

Fourth, the Division contends that the records are "highly relevant" to the Division's claim that Partners is vicariously liable as Global IV's "control person," because those records show that Partners' principals directed Global IV to make "payments and money movements." Opp. at 9. Without more, that argument fails to show the evidence's relevance: That one party directs another's money movements does not establish that the former is a control person. In *In re Bernard L. Madoff Inv. Sec. LLC*, for example, the court held that an investor who directs an investment vehicle to remit his trading proceeds is not the vehicle's control person under Exchange Act § 20. No. 12-6109, 2013 WL 5511027, at *6-10 (S.D.N.Y. Sept. 30, 2013). Thus, this argument does not make the Division's banking records relevant here.

CONCLUSION

For these reasons, the Court should grant Respondents' Motions in Limine.

Dated: November 16, 2016.

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CERTIFICATE OF SERVICE

I hereby certify that on November 16, 2016, I filed an original and three copies of the foregoing with the Office of the Secretary, Securities and Exchange Commission, Attn: Secretary of Commission Brent J. Fields, 100 F Street NE, Mail Stop 1090, Washington, DC 20549, by Federal Express overnight delivery and filed a copy by facsimile transmission to (202) 772-9324, and served a true and correct copy upon counsel of record by electronic mail (and also by Fedex delivery to Division counsel), as follows:

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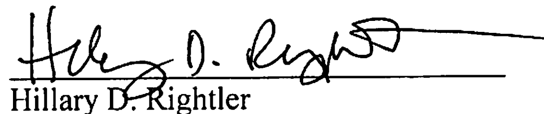

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