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Ironridge Hits Back at SEC Action on Section 3(a)10 Deals

By Teri Buhl

Ironridge Global Partners is fighting back against a Securities and Exchange Commission suit to force the San Francisco-based firm to become a broker-dealer or halt its controversial equity-for-liabilities swap deals. The controversy is centered on a finance scheme pioneered by Ironridge that turns unpaid claims into equity and bypasses the requirement to hold restricted stock from trading.

On June 23 the SEC sued Ironridge through their administrative law court for Section 15(a) and 20(b) violations aimed at the large volume of deals Ironridge has closed over the past three years using the Section 3(a)(10) exemption. In the suit the regulator claims the fund manager is acting as an unregistered underwriter. Ironridge fired back on July 14, filing suit in Atlanta federal court trying to stay the SEC action because the fund manager claims the SEC's administrative hearing process violates its Seventh Amendment rights to a jury trial and is an unconstitutional proceeding.

More than half a dozen microcap finance firms now use the 3(a)(10) exemption to buy trade claims from creditors of issuers and then get court approval to convert them to equity through a fairness hearing. The company then pays firms like Ironridge in unrestricted stock for the claims relief, which can be traded immediately in the open market.

An 8-K announcement of the financing and new shares issued is required by the issuer and the investment firm must file a 13G report with the SEC explaining how it received the free trading shares and the amount it owns. Enforcement staff at the agency accuse 3(a)(10) finance firms of not filing these deal announcements in a timely way or explaining how the financing really works in SEC documents. Ironridge disclosed in court filings that the SEC investigated the firm for fraud over an 18-month period but were unable to find grounds to bring a fraud charges.

Ironridge principals told *Growth Capital Investor* if the courts rule the firm needs to be a broker-dealer it will become one, but in the meantime the firm will continue to do deals under its "LIFE" (Liability for Equity) program using the applicable securities exemptions the law currently allows. Section 3(a)(10) was intended to be used for companies filing Chapter 11 bankruptcy reorganization so they could pay off creditors with stock. Creditors take these payments in hopes of the company returning to health after it comes out of bankruptcy.

Ironridge was founded by John Kirkland, a former securities lawyer at **Greenberg Traurig**, who saw the opportunity to use the exemption in other ways. From April 2011 to March 2014 Ironridge closed 33 transactions with 28 emerging growth companies, structured as Section 3(a)(10) deals according to the SEC lawsuit.

OTC Markets Group President Cromwell Coulson told *Growth Capital Investor,* "We are definitely seeing the SEC try to force these firms to become a regulated entity so they have better means to track and monitor shares issued under broker-dealer rules." But other market participants and defense lawyers question why the SEC doesn't just issue new rules on how the exemption can be used instead of suing through their controversial administrative courts. The administrative court proceedings, before judges appointed by the SEC, offer less options for those accused of securities law infractions in areas such as rules of discovery than traditional courts.

"This case reflects the SEC's continued aggressive interpretations of the federal securities laws in the microcap space," says Nicolas Morgan, a former SEC enforcement attorney and partner at **Zaccaro Morgan**. "The SEC does not allege fraud or investor harm. The SEC also does not challenge Ironridge's innovative use of Securities Act Section 3(a)(10) as an exemption to registration to acquire shares from small public companies in settlement of litigation claims against the issuers. Indeed, all of the settlements appear to have been approved by courts in 'fairness hearings'.

"Rather," Morgan continues, "the SEC challenges Ironridge's repeated use of the Section 3(a)(10) exemption, alleging that Ironridge became a securities broker-dealer and was not registered to act in that capacity. While the SEC's allegations don't make clear whether it views Ironridge as a broker, effecting transactions for the account of others, or as a dealer, buying and selling securities for its own account, the SEC's allegations don't paint Ironridge with many of the hallmark characteristics of a securities dealer.

"For example, the SEC doesn't allege that Ironridge carries an inventory, quotes a market, or lends securities or extends credit to customers. Some aspects of Ironridge's model make it appear more like a trader or investor than a broker or dealer. In the absence of fraud, investor harm, or a violation of the securities registration provisions, and given the novelty of

Ironridge's business model, clarifying statutory vagueness through enforcement litigation rather than rule making or staff interpretations appears heavy handed."

Ironridge's Kirkland has said previously that one of the main reasons the firm hasn't applied for a broker-dealer license is because "it's a pain in the ass". Kirkland said that Ironridge relies on a no-action letter from the SEC issued in 2001 regarding a deal by **Acqua Wellington North American Equities Fund** for guidance on the 3(a)(10) exemption. Ironridge is not alone among funds that have chosen to forego the broker-dealer route. **Magna Group**, **Compass Capital, IBC Funds**, and **Socius Capital Group** (now called **Crede**) follow the same model as Ironridge.

People involved in the SEC investigations told *Growth Capital Investor* they believe Ironridge is the first firm the SEC sued because they wouldn't bow to SEC pressure to become a broker-dealer. There are at least three other firms under investigation who are currently discussing settlements with the regulator. The SEC has even promised some firms the agency will not to bring fraud charges against them for actions in 3(a)(10) if they settle and agree to become broker-dealers.

Hints of regulatory issues with 3(a)(10) deals were first seen last November, when the SEC brought enforcement actions against 10 issuers for lack of disclosure about 3(a)(10) financing by not promptly disclosing the deals in 8-K filings. All 10 issuers settled with the SEC. All of the companies had closed 3(a)(10) financing by IBC Funds LLC, managed by Samuel Oshana and Bryan Collins according to SEC filings. Both managing directors are based in Florida and have used one South Florida judge primarily to approve their 3(a)(10) deals, according to court documents. The duo uses the names **IBC Holdings**, **IBC Funds** and **IBC Equity** in their SEC filings. Bryan Collins also owns **Greystone Capital**.

Crede Capital, is owned by a Los Angeles-based man named Terren Peizer, who as a young broker testified against Michael Milken in the junk-bond scandal of the 80s. The firm changed its name from Socius a few years ago while a former deal finder sued the firm for not paying him millions in fees he believed was owed him from Socius' PIPE deals.

Terren's partner is a convicted felon named Michael Wachs. The duo has used several entities including **Acuitas Financial Group**, **Reserva Capital**, **Bonmore LLC**, **Crede CG II Ltd**, **Optimus Capital**, and **Socius CG** to fund deals. A search in EDGAR, the online SEC document tracking system, shows financing deals Peizer has done often have amended 13G's where the number of shares issued or how the financing was structured are re-explained.

Magna Group is founded by an under-30 New Yorker that *Bloomberg* recently profiled as a Wall Street whiz kid named Josh Sason. Magna was involved in a 3(a)(10) deal with **Newlead Holdings (NEWL)**, a shipping container company, that came under fire by NASDAQ for misleading SEC filings. In 2014 NASDAQ demanded the company's executives meet with the exchange to answer questions regarding its reporting of its debt relief and share dilution via its 3(a)(10) deals, and eventually kicked the company off the exchange.

IBC Funds, Magna, and Crede did not respond to requests to discuss their settlement talks with the SEC regarding their role in Section 3(a)(10) deals. In 2012 the SEC sued Compass Capital Group and their affiliate **Sequoia International** for repeated misuse of exemption from registration in Section 3(a)(10) deals.

Ironridge's strategy to use the federal courts to stop the SEC's administrative hearing process is not a new one. Lynn Tilton, who is accused of misleading investors about the value of CDO deals in her fund, was recently denied a similar move in federal court and now has to try her case in administrative court.

Andrew Ceresney, the SEC's chief litigator, recently told a PLI talk in New York that the Commission is using the administrative courts in more cases because it is faster than the federal court process and costs the taxpayers less in litigation fees. Until a change was made in Dodd-Frank legislation the SEC could only use the administrative hearings for firms that were registered with the Commission, but that law is being questioned now in court.

Ironridge is arguing in court documents that since they are not an SEC registered firm, the SEC should not be able to use the administrative court process. Stephen Hudson of **Kilpatrick Townsend and Stockton LLP** an Atlanta-based law firm is representing Ironridge.