Securities Regulation Daily Wrap Up, ENFORCEMENT—N.D. Ga.: 'Liabilities for equity' company sues to stop SEC administrative proceeding, (Jul. 16, 2015)

By Matthew Garza, J.D.

A company hauled before the SEC's administrative court for failing to register as a broker-dealer has joined a long list of SEC targets decrying the agency's in-house proceedings as unconstitutional. Ironridge Global Partners and its subsidiary filed suit in the Northern District of Georgia after it was accused of being in violation of SEC broker-dealer registration provisions through the use of a unique microcap financing business model. The company complained that the proceeding was unconstitutional because it abridged its right to a jury trial and was conducted by an inferior officer that was insulated by tenure protection and not appointed by SEC Commissioners, in violation of Article II (*Ironridge Global IV, Ltd. v. SEC*, July 14, 2015).

The SEC brought the administrative action against Ironridge on June 23, accusing the company of acting as an unregistered broker-dealer by engaging in serial underwriting activity, offering investment advice, and receiving and selling billions of shares of stock in microcap companies.

LIFE financing. The company's business model takes advantage of Securities Act Section 3(a)(10) , which exempts from registration securities issued in court-approved exchanges for "bona fide outstanding claims." The SEC said the company designed and promoted a "Liabilities for Equity" (LIFE) financing program in which it arranged to have a subsidiary purchase outstanding claims from microcap issuers' creditors and then settle those claims through Sec. 3(a)(10) exchanges. Ironridge received microcap stock at steeply discounted prices in the settlements and then sold the shares.

The SEC said Ironridge's principals would sometimes work with the issuers to identify creditor claims and negotiate with the creditors for purchase of the claims, then sue the issuer in California state court to collect on the claims. The SEC said the 3(a)(10) transactions significantly increased the public float of many of the issuers, and Ironridge's subsequent sales often represented a large percentage of the total trading volume for the issuer's shares. The flood of shares onto the market typically drove down the share price and increased the number of shares due to the company under the settlements. The principals then communicated requests for additional shares directly to the issuers or their transfer agents, which meant they "controlled or directed" the issuance of new shares to the company, according to the SEC.

The SEC specified that the company received and sold about 5.5 billion shares of stock, realizing proceeds of approximately $56 million and net profits of approximately $22 million in 33 separate exchanges between April 2011 and March 26, 2014. The SEC claimed the conduct represented a willful violation of Exchange Act Sec. 15(a), which prohibits a broker or dealer from effecting transactions in any security without registration.

Ironridge fires back. The company, which the complaint pointed out was founded by an experienced securities attorney along with an investment banker and two investment advisers, quickly challenged the cease and desist proceeding as unconstitutional. The company said that the agency's contention that it was a broker-dealer relied on a "novel interpretation" of that phrase and was unsupported by the law and contrary to SEC guidance. The SEC's proceeding did not accuse the company of violating Securities Act Sec. 5's requirements for registration of securities, nor did it allege any fraud or investor harm, Ironridge pointed out. "That order swept Plaintiffs into an administrative proceeding riddled with Constitutional defects," Ironridge complained. The company sought an injunction to halt the SEC's action and a declaratory judgment that the proceedings are unconstitutional.

The case is No. 1:15-cv-02512-LMM.

Attorneys: Akash Desai (Kilpatrick Townsend & Stockton LLP) for Ironridge Global IV, Ltd. and Ironridge Global Partners, LLC.

Companies: Ironridge Global IV, Ltd.; Ironridge Global Partners, LLC

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