GIBSON DUNN

Gibson, Dunn & Crutcher LLP

1050 Connecticut Avenue, N.W.
Washington, DC 20036-5306
Tel 202.955.8500
www.gibsondunn.com

Helgi C. Walker
[redacted]

November 15, 2021

VIA E-MAIL (rule-comments@sec.gov)

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: SEC Small Business Capital Formation Advisory Committee Meeting
File No. 265-32

Dear Ms. Countryman:

We write in connection with the upcoming meeting of the SEC Small Business Capital Formation Advisory Committee. The SEC has invited the public to submit written statements to the Committee.

As detailed in our enclosed prior submission in connection with the proposed amendment to Rule 144, *see* Rule 144 Holding Period and Form 144 Filings, 86 Fed. Reg. 5063 (Jan. 19, 2021), we believe the proposed amendment (if adopted) would have a disastrous effect on small public company capital formation. We therefore urge the Committee to consider the effects of the proposed amendment on small business capital formation.

Respectfully submitted,

/s/ Helgi C. Walker

Helgi C. Walker
Barry Goldsmith
M. Jonathan Seibald
Brian A. Richman
GIBSON, DUNN & CRUTCHER LLP

Before the
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Rule 144 Holding Period and Form 144 Filings	File No. S7-24-20 RIN 3235-AM78

COMMENTS OF THE SMALL PUBLIC COMPANY COALITION ON THE PROPOSED AMENDMENT TO RULE 144

Helgi C. Walker
Brian A. Richman
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Avenue, N.W.
Washington, DC 20036-5306
(202) 955-8500
hwalker@gibsondunn.com

Barry Goldsmith
M. Jonathan Seibald
GIBSON, DUNN & CRUTCHER LLP
200 Park Avenue
New York, NY 10166-0193
(212) 351-2440
bgoldsmith@gibsondunn.com

Attorneys for
Small Public Company Coalition

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INTRODUCTION

The Securities and Exchange Commission is about to bankrupt hundreds, if not thousands, of small public companies—for no apparent reason other than a distaste for so-called "penny stocks." Reversing decades of prior Commission decisions, the proposed amendment to Rule 144 to eliminate tacking in calculating the holding period for market-adjustable convertible loans to unlisted (or over-the-counter) issuers would eliminate a vital source of funding for many of our nation's smallest public companies—firms that generally cannot obtain affordable capital from other sources and are already struggling under the weight of COVID-19. And to what end? The Commission identifies no problem or market failure, either real or theoretical, that would warrant such a radical intervention in our public markets. Indeed, the agency frankly admits it has no idea whether the proposed rule would benefit investors at all: "the net effect of the proposed amendment on . . . existing shareholders is unclear." Rule 144 Holding Periods and Form 144 Filings, 86 Fed. Reg. 5063, 5074 (Jan. 19, 2021).

In its rush to condemn a newly disfavored industry, the SEC sidesteps its statutory duty to inform itself—and more importantly, the public—of the economic consequences of its proposal. The Commission's scant two-paragraphs of purported economic analysis is so wanting that the agency devotes just a single sentence to the rule's effects on market competition and efficiency—two factors that Congress has ordered the SEC to consider in proposing any rule. Even then, the best the Commission can

do is throw up its hands and say that the anticipated impact is not "reliably quantif[iable]." 86 Fed. Reg. at 5074. That non-determination alone should be the end of this rulemaking. When a federal agency tasked with resolving an important policy issue cannot even venture a guess as to the likely impact of its own proposal, it is time to drop the idea until the required analysis can properly be done—not barrel ahead, reversing in part decades of prior rulemakings in the process, consequences be damned.

The proposed rule would be a disaster for small businesses and their shareholders. The Commission admits that unlisted small public companies often have one source—and only one source—of quick, affordable capital: market-adjustable convertible securities (often loans). Yet the Commission proposes rule changes that would effectively take that source of capital, and the opportunity for success that comes with it, away—and in the midst of a global pandemic, no less. No good will come from this. As the CEOs and other senior officers of 62 small public companies from around the country explain in their comments to the Commission, the proposed rule would eliminate a "vital source of financing" and drive many firms "out of business altogether"—kicking Americans out of their jobs and wiping out the investments of the very investors the Commission claims to be protecting.

The Small Public Company Coalition ("SPCC") respectfully urges the Commission to withdraw its misguided proposal and to reaffirm its longstanding commitment to supporting our nation's smallest public companies as they seek the capital they need

to serve their customers and their shareholders, and to grow into the American success stories of tomorrow.

* * *

If the Commission adopts this ill-advised proposal, the final rule will fail to survive judicial review.

The Proposed Rule Is Arbitrary And Capricious. The proposed rule is arbitrary and capricious for a multitude of reasons. The Commission has demonstrated no real problem that the proposed rule will address. Nor has the Commission addressed the very real problems that the proposed rule will create—from depriving firms of a critical form of financing (during a global public health emergency, no less), to discouraging public financial disclosures, to making fraud more likely.

The Proposed Rule Would Reduce Efficiency, Stifle Competition, And Deter Capital Formation. The proposed rule independently would violate the Securities Act and the Exchange Act because it does not promote efficiency, competition, and capital formation. The Commission admits that it cannot show otherwise—a statutory violation that again confirms the proposed rule is arbitrary and capricious.

The Costs Of The Proposed Rule Far Exceed The Benefits. The Commission's purported economic analysis fails to show that the benefits of the proposed rule exceed the costs. In fact, the record evidence will show that the reverse is true. The Commission fails to consider the sufficiency of existing protections that address the Commission's stated concerns, and the Commission severely underestimates the actual costs of

its proposal—including the following: eliminating this "last resort" form of financing for many unlisted issuers; raising the cost of capital (both debt and equity); increasing the bankruptcy risk of small public companies; discouraging investors from investing in small public companies; destroying shareholder value; threatening the jobs of thousands of Americans; decreasing public company disclosures and transparency; and increasing the likelihood of fraud.

The Proposed Rule Would Violate The Administrative Procedure Act. The Commission has not only failed to apprise itself of the economic consequences of its proposal, it has withheld from the public the very data—cited in the proposed rule—that would allow the public to evaluate and meaningfully comment on those consequences. For two months, the Commission has ignored requests to release that data. The Administrative Procedure Act, however, does not permit the Commission to make rules in secret, even if it would prefer to avoid public scrutiny.

BACKGROUND

A. The Small Public Company Coalition

Small public companies are a major engine of our economy. They employ many thousands of Americans developing new and innovative products and services. Yet they are often overlooked by Wall Street, and, increasingly, have come under threat

from onerous government regulation.[1] The Small Public Company Coalition is their voice. The SPCC's mission is to protect this industry, and the financial professionals who serve it, from harmful government interference that suppresses growth, hinders capital formation, and eliminates jobs. An important function of the SPCC, therefore, is to represent the interests of its members in matters before Congress, the courts, and the Executive Branch. To that end, the SPCC comments on—and if necessary, challenges—rulemakings, such as the present one, that threaten the ability of small public companies to obtain the investment capital they need to establish themselves, grow, and ultimately thrive. *See* Small Pub. Co. Coalition, *A Little Bit About Us*, https://thespcc.com/about/ (last visited Mar. 19, 2021).

[1] The present rulemaking is just one front in a broader, ill-conceived assault on the convertible lending industry. The Commission, for example, has wielded its investigatory and supervisory powers to intimidate or otherwise coerce brokers into declining to accept deposits from perfectly legal convertible note lenders. And, more recently, it has filed a series of baseless enforcement actions accusing convertible note lenders of operating as unregistered "dealers," employing a bizarre legal theory that is not only fundamentally inconsistent with the Commission's proposal here, but (if adopted) would make illegal the operations of virtually every hedge fund, investment company, family office, and venture capital firm. *See* Helgi Walker, Barry Goldsmith, Jonathan Seibald, & Brian Richman, *Aggressive SEC Enforcement Actions Could Limit Small Business Recovery Resources*, Nat'l L.J. (Aug. 20, 2020) (Exhibit B).

B. Market-Adjustable Convertible Notes

Market-adjustable convertible notes[2] are a category of debt financing increasingly relied on by smaller, usually development-stage public companies. Development-stage companies, as the name implies, are often developing their business model and acquiring customers, and, therefore, have limited revenue and access to working capital. Market-adjustable convertible notes offer firms like these a quick, affordable way to finance their nascent operations—to pay their employees and vendors, and to set themselves up for future success.

Here is how it works. The transaction begins as a standard loan. The small public company will borrow, say, $100,000, and agree to pay back principal and interest at a later date. Like a typical loan, the small public company generally has the option to pay off the loan in cash—often within six months. But because smaller companies often have limited access to cash—or, frequently, could put cash to better use growing their business—the loan documents offer an alternative method of payment: a conversion. If the borrower does not elect to repay the loan in cash, the outstanding balance (or a portion thereof) can be converted into shares of the borrower's stock and trans-

[2] Because the market-adjustable convertible securities targeted by the present proposal are often in the form of notes, this comment will generally refer to "notes." This comment, however, applies equally to all market-adjustable convertible securities.

ferred to the lender. Companies often choose this option—a common form of financing in public and private markets—which allows them to preserve valuable cash, while, at the same time, permitting the lender to recoup its capital.

The conversion necessarily occurs at a discount to market price to compensate the lender for the risk that it incurs in making the loan. *See, e.g.*, Revision of Holding Period Requirements in Rules 144 and 145, 62 Fed. Reg. 9242 (Feb. 28, 1997); *see also* Proposing Release, 86 Fed. Reg. at 5074.[3] And that discount is often market adjustable—hence the name, market-adjustable convertible notes. This means that rather than setting a fixed discount upfront, the loan documents peg the discount to the stock's market price at the time of conversion. As the Commission acknowledges, the market-adjustable nature of the loans allows lenders to offer smaller discounts—i.e., cheaper loans—because they do not have to build in extra protection, at the outset, for potential drops in the borrower's stock price in the time period between the loan and the conversion. *See* 86 Fed. Reg. at 5074.

As the record in this rulemaking confirms, and as we detail below, these loans "are a benefit for all part[ies] including the lender, the issuer and the shareholders. They are an efficient method for small businesses to access working capital quickly while

[3] Some convertible deals carry more bespoke terms—for example, a conversion price that is part fixed, part variable, depending on market price.

providing the option to repay the loan or have the lender convert into equity." Comment of Brad J. Moynes, CEO, Digatrade Fin. Corp. (Feb. 4, 2021).

1. The Commission Has Long Encouraged Convertible Financing.

Convertible financing is not new. Market-adjustable securities have been around since the 1990s, if not earlier. 86 Fed. Reg. at 5072. And the Commission and its staff have long recognized the benefit of permitting a lender to "conver[t]" an outstanding debt into the borrower's "stock" and to "sell the . . . stock in the public market" to recoup the lender's capital—and have interpreted Rule 144 accordingly. *Planning Research Corp.*, 1980 WL 14999, at *2 (SEC No-Action Letter Dec. 8, 1980); *see also* Revisions to Rules 144 and 145, 72 Fed. Reg. 71,546, 71,555 & n.143 (Dec. 17, 2007) (adopting the *Planning Research* position).

The Commission designed Rule 144 to promote capital formation. When firms—typically, smaller firms—cannot raise capital in public markets or afford the high costs of registration, they often turn to private transactions—transactions that are not registered with the Commission. Rule 144 facilitates these transactions by allowing the capital provider to resell the securities it receives in these private transactions (or securities converted from those securities) after an SEC-mandated holding period. Among other things, the holding period provides an "objective criteria for determining" that the holder of the restricted securities had been acting for its own economic interest,

not as a mere agent of the borrower hired for the sole purpose of distributing unregistered securities. 72 Fed. Reg. at 71,549. The Commission has consistently maintained that the holding period should "be no longer than necessary or impose any unnecessary costs or restrictions on capital formation." *Id.* And, in 2007, "[a]fter [having] observ[ed] the operation of Rule 144" for over a decade, the Commission concluded that a "six-month holding period" was enough for both listed and unlisted reporting companies who are current on their financial reports. *Id.*; *see also* 86 Fed. Reg. at 5066 ("A variation of this provision has existed since 1972").

At the same time, the Commission formally codified the agency's longstanding support of convertible transactions. Because a conversion—as relevant here, from a note to a stock—simply "continues the [lenders] investment in the *same* issuer," Revision of Rule 144, Rule 145 and Form 144, 62 Fed. Reg. 9246, 9249 (Feb. 28, 1997), the Commission adopted a formal rule permitting the lender to "tack" the holding period of the original note onto the holding period of the converted stock, 72 Fed. Reg. at 71,555. As a result, once the lender had held the note for six months, it could convert the note into stock (usually at the borrower's option) and—counting the six months it had held the note—immediately sell the stock into the market to recoup its capital. *See id.*

As the Commission has long acknowledged, the "benefit" of a "liberalized tacking principle" is that the capital provider can "res[ell]" the acquired securities "sooner." Self-Regulatory Organization Automated Systems, 55 Fed. Reg. 17,932, 17,943 (Apr.

30, 1990). The ability to resell the securities on a shorter timeline lowers the lender's risk, because the longer the holding period drags on, the more can go wrong—particularly with smaller companies—that could prevent the lender from recouping its capital. 72 Fed. Reg. at 71,562. The lower risk translates into cheaper, more affordable loans. *See id.*

2. Small Public Companies Rely On Market-Adjustable Convertible Securities To Grow And Thrive.

As 62 "representatives of new and emerging companies that are not listed on a national securities exchange" explain, "it is often extremely difficult for [their firms] to obtain financing from more traditional sources of funding in order to execute [their] business plans and grow [their] businesses." Comment of 62 Small Public Companies That Rely On Market-Adjustable Convertible Notes at 1 ("Comment of 62 Small Public Companies"). Market-adjustable convertible note lenders "have stepped into this void [to] provide[ ] the vital funding [small] companies need"; [w]ithout these convertible loans, [smaller public companies] absolutely would not . . . be[ ] able to grow [their] companies." *Id.*; *accord* Comment of Sec. Transfer Ass'n (Feb. 22, 2021) (recognizing the "importance . . . of convertible debt financing, particularly to microcap issuers to whom conventional means of financing are often not available").

The reality is that lending to small public companies is inherently risky. Most lenders won't do it. *See* Comment of 62 Small Public Companies at 1. Development-stage firms often have "low- or no-revenue," 86 Fed. Reg. at 5072, and thus operate

with an "elevated likelihood[ ] of bankruptcy," *id.* at 5074. Although these firms have "higher growth" potential, *id.*, and some hit it out of the park, others are less fortunate; and all generally lack the cashflow or collateral required by traditional lenders, *see, e.g.*, Crowdfunding, 80 Fed. Reg. 71,388, 71,492 (Nov. 16, 2015) (observing that startups and small businesses can "have difficulty raising capital" because they "have smaller and more variable cash flows . . . [and] less collateral for traditional bank loans" (footnote omitted)); Exemptions to Facilitate Intrastate and Regional Securities Offerings, 80 Fed. Reg. 69,786, 69,813 (Nov. 10, 2014) ("Borrowing from financial institutions is . . . relatively costly for many early-stage issuers and small businesses as they may have low revenues, irregular cash-flow projections, [and] insufficient assets to offer as collateral . . . . Many startups and small businesses may find loan requirements imposed by [traditional] financial institutions difficult to meet"; "[f]or example, financial institutions generally require . . . collateral and/or a guarantee, which startups, small businesses and their owners may not be able to provide." (footnote omitted)). Accordingly, market-adjustable convertible loans are often the only source of affordable financing available to these smaller public companies. The discounted conversion feature gives the lender just enough protection (akin to a form of collateral) to offer a loan that is economical to both parties.

These loans are enormously useful to smaller public businesses. The cash allows firms to keep the lights on—often, literally—while they set themselves up for growth. That growth can be substantial. Take just one example: FuboTV. In 2017 and 2018,

FuboTV (then known as Pulse Evolution Group) had no revenue.[4] During that time, it issued a series of convertible notes to stay afloat and continue to grow its business.[5] By 2020, FuboTV was earning $44,172,000 per year in revenue,[6] so it paid back its convertible loans (opting to do so in cash),[7] and publicly listed on the New York Stock Exchange. Today, the company is valued at over $600 million.[8] Market-adjustable convertible loans made it possible.

3. Market-Adjustable Convertible Notes Offer Small Public Companies Significant Comparative Benefits.

Market-adjustable convertible notes offer small public companies (and their shareholders) significant benefits over alternative forms of financing. Most obviously, market-adjustable convertible notes are *available*; as discussed, smaller public companies often lack access to other forms of financing. *See* Comment of 62 Small Public Companies at 1.

Market-adjustable convertible notes are also *affordable*. If lenders had to select a fixed conversion-discount upfront, they would need to account for any possible decline in the borrower's stock price at the outset, requiring tremendous discounts in every

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[4] *See* Pulse Evolution Group, Inc., Annual Report, at F-4 (Form 10-K) (June 10, 2019).

[5] *See id.* at F-18 to F-21.

[6] *See* FuboTV, Inc., Prospectus 6 (Form 424B4) (Oct. 9, 2020).

[7] *See id.* at F-92.

[8] *Streaming Provider FuboTV Raises $183 Million in IPO Ahead of NYSE Debut*, Reuters (Oct. 7, 2020), https://www.reuters.com/article/fubotv-ipo/streaming-provider-fubotv-raises-183-million-in-ipo-ahead-of-nyse-debut-idUSKBN26T0BZ.

deal. *See* 86 Fed. Reg. at 5074. By adjusting the conversion price based on the market price at the time of conversion, market-adjustable convertible notes allow lenders to offer better pricing. And by permitting the borrower to pay back all or a portion of the note in stock, rather than cash, the terms of the note make it more likely that borrowers will be able to pay back the loan—again, allowing lenders to offer better rates. This method of financing, moreover, is usually only employed for a limited time; while a company may "start[ ] with convertible note financing" to plug a temporary shortfall, the much-needed cash infusion helps the company ratchet "up growth to achieve future rounds of financing" through other mechanisms at even "more favorable rates." Comment of Robert Rositano Jr., CEO, Friendable, Inc. (Feb. 22, 2021).

What's more, market-adjustable convertible notes are efficient, and offer a borrower valuable flexibility. Borrowers can receive funds in as little as 24 hours. *See* Comment of Brad J. Moynes, CEO, Digatrade Fin. Corp. (Feb. 4, 2021) (the funds arrive "quickly"). And they typically can decide at the time of repayment—not months earlier—what payment method is best suited to their needs. As former SEC Chief Economist Jim Overdahl explains, many borrowers may "value the cash proceeds"—perhaps they could put the cash to better use opening a new customer service, rather than paying back a loan—and thus may rationally "opt[ ] to pay back their loans through conversion." Report of James A. Overdahl, Ph.D., at 15 n.7 (Mar. 20, 2021) (Exhibit A) ("Overdahl Report"). Only convertible notes offer this valuable flexibility.

4. Market-Adjustable Convertible Notes Are Subject To The Same Or Similar Regulations As Other Forms Of Financing.

Market-adjustable convertible notes are regulated like other forms of financing. Even though Rule-144-deals are unregistered, Rule 144 itself conditions a lender's ability to utilize the six-month holding period to resell stock on (among other things) "[a]dequate current public information" existing about the borrower. 17 C.F.R. § 230.144(c). Accordingly, when a lender resells stock to recoup its capital after the six-month holding period as part of a market-adjustable convertible note deal, it is necessarily the case that the borrower whose stock is being sold has issued "all required reports under section 13 or 15(d) of the Exchange Act . . . during the 12 months preceding [the] sale," *Id.* § 230.144(c)(1)(i), including "quarterly reports" and "annual reports" "certified . . . by independent public accountants," 15 U.S.C. § 78m(a)(2).

In addition, both the lender and the borrower must comply with the standard anti-fraud rules, which are applicable to the purchase or sale of "any security," registered or not. 15 U.S.C. § 78j(b); *see also* 17 C.F.R. § 240.10b-5. This regulatory and disclosure framework provides robust protections for investors.

5. Market-Adjustable Convertible Notes Are Accompanied By Substantial Investor Disclosures.

The disclosure requirements extend beyond the financial condition of the borrower; the terms of the market-adjustable convertible notes are disclosed to the Commission and the public months before any potential conversion. *See* Comment of 62 Small Public Companies at 2 ("These loans are typically publicly disclosed at the time

the loans are made, so existing and potential shareholders are fully aware of the loans many months before there is any potential conversion."); *In re Elray Res., Inc.*, 2016 WL 5571631, at *2 (Sept. 30, 2016) (holding that borrower was required "to file a Form 8-K with the Commission within four business days of the sale of any of the convertible notes"); *see also* 17 C.F.R. §§ 229.10(a)(2), 229.701(e) (requiring disclosure of convertible-note issuances on Forms 10-K and 10-Q). This disclosure "gives potential shareholders the opportunity to decline to invest in companies that have received these loans, and existing shareholders the opportunity to sell their shares well before any potential conversion." Comment of 62 Small Public Companies at 2.

C. The Proposed Rule

The Commission's proposed rule would destroy the market for market-adjustable convertible notes, driving scores of small public companies out of business. Specifically, the Commission would eliminate the longstanding "tacking" provision, which permits lenders to count the time they held the note towards the holding period for any converted stock. As a result, lenders would not be able to sell the stock to recoup their capital immediately on conversion; they would need to wait an additional six months. As the Commission admits, this amendment would "introduce greater risk" for the lenders and "discourage" lenders from offering market-adjustable securities at all. 86 Fed. Reg. at 5073. This concern is fully borne out by the record: with the "added risk," "[m]any convertible lenders would likely cease lending entirely." Comment of 62 Small Public Companies at 2.

That would be a death sentence for an untold number of small public companies. The Commission itself admits that market-adjustable convertible loans are often the *only* form of financing small public companies have available. *See* 86 Fed. Reg. at 5074. Without that valuable form of financing, many firms would simply not survive, as the record here confirms. *See, e.g.*, Comment of Mark L. Kay, CEO, StrikeForce Techs., Inc. (Jan. 27, 2021) ("Without these type of deals we would have not survived and thank God they existed and therefore kept us alive.").

Neither small public companies nor the investing public would be served by the needless destruction of scores of businesses.

DISCUSSION

I. The Proposed Rule Is Arbitrary And Capricious Because It Is Unnecessary, Ineffective, And Counterproductive.

A. The Commission Has Not Demonstrated A Need For Eliminating A Vital Source Of Financing For Thousands Of Smaller Public Companies.

The proposed rule is a solution in search of a problem. "Market-adjustable securities are an innovation in the market for convertible securities dating back to the 1990s." 86 Fed. Reg. at 5072. During this time, market-adjustable convertible notes have amassed a strong track record of providing transparent and flexible funding to small, emerging companies that generally cannot obtain capital from other sources. Smaller companies have turned to market-adjustable convertible loans on thousands of occasions, producing the potential for growth and opportunity in our economy and

furthering the Commission's own policy goals of promoting capital formation under Rule 144. *See id.* at 5073 & n.79 (counting a "lower bound" of 207 deals in 2019 alone). Given this long history and extensive use, it is remarkable that the Commission does not identify even a single convertible loan that it—or any investor—has found problematic. It is even more remarkable that the Commission has issued a proposal that would fundamentally transform—if not entirely eliminate—a vital source of funding for thousands of smaller public companies without any evidence or explanation as to why the change is necessary. *See Nat'l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 843 (D.C. Cir. 2006) (Kavanaugh, J.) ("Professing that an order ameliorates a real industry problem but then citing no evidence demonstrating that there is in fact an industry problem is not reasoned decisionmaking.").

1. The Commission Has No Evidence That Market-Adjustable Convertible Note Lenders Are Participating In Unregistered Distributions.

The Commission's primary justification for the proposed rule is an asserted concern that some convertible lenders may be acquiring "market-adjustable securities with a view to an unregistered distribution of the underlying" common stock. 86 Fed. Reg. at 5067. The Commission repeats this concern over and over. *See, e.g.*, *id.* at 5064 ("We are proposing this amendment to mitigate the risk of unregistered distributions in connection with sales of market-adjustable securities."); *id.* at 5066 (lenders "have an incentive to purchase the market-adjustable securities with a view to distribution of the underlying securities following conversion"); *id.* at 5067 ("We believe the proposed

amendment would reduce the potential for unregistered distributions . . . ."); *id.* at 5073 ("We believe this proposed amendment would curb the occurrence of situations where purchasers of such instruments have a view to an unregistered public distribution."). But the agency has "provided *zero* evidence of" any lender—ever—having purchased a market-adjustable security with a view to an unregistered distribution of common stock. *Nat'l Fuel*, 468 F.3d at 843. That alone should be the end of this rulemaking. "Rules are not adopted in search of regulatory problems to solve; they are adopted to correct problems with existing regulatory requirements that an agency has delegated authority to address." *N.Y. Stock Exchange LLC v. SEC*, 962 F.3d 541, 556–57 (D.C. Cir. 2020). "That is not the situation that we [face] in this case." *Id.* at 557.

The Commission not only lacks any evidence that lenders are *actually* acquiring market-adjustable convertible notes under Rule 144 with a view to an unregistered distribution of common stock; the agency cannot rationally explain *why* it thinks this hypothetical conduct might be happening. The best the Commission can do is claim that market-adjustable securities "typically" convert into common stock at a "discount[ ]" to market price, which protects the lenders "against investment losses" they would otherwise have incurred had they held non-adjustable notes for the Rule-144 holding period. 86 Fed. Reg. at 5066. From this, the Commission leaps to the erroneous conclusion that the lenders do not have any "economic risks of investment," and thus might be using the convertible loans to "act[ ] as conduits for [the] sale . . . of unregistered

securities . . . on behalf of an issuer." *Id.* That assertion is deeply flawed on numerous levels.

First, the Commission's premise—that holders of market-adjustable securities do not face any "economic risks of investment"—is absurd. 86 Fed. Reg. at 5066. Lending to small, emerging companies is a highly risky endeavor. The Commission itself concedes that recipients of convertible loans are generally emerging, "low- or no-revenue firms," *id.* at 5072, in high-risk (albeit high-growth) industries—such as "pharmaceutical, biotechnology, and business technology," *id.* at 5073—that often face an elevated risk of "bankruptcy," *id.* at 5072 & n.75. The value of many convertible notes, therefore, literally goes to zero; "profit" is never guaranteed. *Id.* at 5066. Unsurprisingly, the Commission cites no authority whatsoever for its assertion that market-adjustable convertible loans "carry little risk" for the lender. *Id.* Consider the market-adjustable convertible loan issued to CurAegis Technologies, Inc., on January 6, 2021. *See* Current Report (Form 8-K) (Jan. 12, 2021). Even though that loan had a "floating conversion rate," 86 Fed. Reg. at 5073, the convertible lender still lost its entire investment just a few months later—the Friday before this comment was filed, *see* CurAegis Techs., Inc., Current Report (Form 8-K) (Mar. 19, 2021) (ceasing operations and defaulting on "outstanding convertible" loan). The Commission's discount-equals-profit theory is like saying a bank faces no risk on a mortgage. Sure, if the consumer stops paying, the bank could foreclose on the home; but there is no guarantee the home will be worth enough

to cover the value of the outstanding mortgage amount. *Cf.* 2008. The same goes for the conversions at issue here.

Other risks abound. Take liquidity. As former SEC Chief Economist Jim Overdahl explains, the "stocks acquired through conversion are by their nature illiquid." Overdahl Report 13. That means that even when a borrower has not declared bankruptcy or otherwise ceased operations, and the lender has been able to acquire shares that still have value, the shares can only "be sold in small increments across time," as market conditions permit. *Id.* Lenders are exposed to significant market risk the entire time. In addition, and contrary to the Commission's assertion, lenders are not able to "immediately" sell anything. 86 Fed. Reg. at 5073. It takes anywhere from an hour to several weeks for the borrower's transfer agent to issuer shares; and once the shares are issued, it could take up to a week or even a month for the lender's broker to deposit the shares into the broker's account. The Commission just ignores this delay and the added risk that comes with it.[9]

And all this, of course, assumes a conversion even occurs. There is always a risk of bankruptcy, as detailed above, that would preclude any conversion; but that is only

[9] The Commission's own rules add to the risk lenders face. Because Rule 144 imposes substantial limits on the ability of an "affiliate of the issuer" to resell converted stock, *see* 17 C.F.R. §§ 230.144(e), (f), lenders will generally seek to avoid affiliate-status by never acquiring more than 4.99% or 9.99% of an issuer's securities. This limitation is yet another factor potentially preventing a lender from "immediately" converting the outstanding loan balance into an issuer's stock—which, again, increases the lender's risk.

one of a multitude of risks a convertible note lender faces that may prevent it from acquiring any marketable shares at all. The borrower, for example, might try to avoid a conversion by revoking its transfer agent's authority to issue new shares, requiring time-consuming, expensive litigation to enforce the lender's conversion rights. *See, e.g.*, Comment of Todd Feinstein, Feinstein Law, P.C. (Jan. 8, 2021) ("Investors in market-adjustable convertible notes very frequently suffer partial or complete loss of their investment due to an issuer's refusal or inability to pay off a note or deliver the shares due thereunder. This is true whether by the issuer's aggressive denials, ghosting, declaration of bankruptcy, filing of often frivolous and far-fetched counterclaims, interpleader, and attempts to characterize the transactions as usurious loans."). Or, during the lender's holding period, the borrower might issue all of its outstanding authorized shares to others, leaving nothing for the lender. Alternatively, the borrower might fall behind on its public filings. While that would not technically prevent a conversion, it would bar the lender from selling any of the converted shares for at least a year, *see* 17 C.F.R. § 230.144(b)(1)(i), if not forever, *see id.* § 230.144(i)—exposing the lender to substantial market risk and leaving it with few ways to recoup its capital. *See* 17 C.F.R. § 230.144(c) (conditioning Rule 144 on certain "public information" conditions). These risks—all unacknowledged by the Commission—thoroughly belie the agency's suggestion that convertible note lenders might merely be acting as "conduits" for the borrowers, 86 Fed. Reg. at 5066, rather than independent, risk-taking investors acting for their own economic self-interest.

Second, even if convertible note lenders were really immune from the "economic risks" of their deals—and they are not—the Commission would *still* have no reasonable basis to suspect that lenders were acting as mere conduits for borrowers. That is because the Commission itself has held that the use of an "economically equivalent" risk-mitigation device—i.e., hedging, Overdahl Report 5–6—is not enough to turn a lender into a conduit of the borrower. Consider this: for borrowers with listed stock, a lender can "continually adjust[ ]" a short position to "lock in the value" of any stock underlying a fixed-rate convertible note, *id.* at 5, also "shift[ing] the economic risk of investment away" from the lender, 72 Fed. Reg. at 71,551. But the Commission has already held that hedgers are not so divorced from the economic risks of their investment that they can fairly be assumed to be acting as conduits of borrowers. *See id.* at 71,552. Like the Commission's former Chief Economist, SPCC too "fail[s] to see why one risk management feature is viewed by the Commission as a failure to assume economic risk while other risk management features are not viewed that way, even though these different risk management features are used for economically equivalent purposes." Overdahl Report 6. Under blackletter administrative law, such a glaring inconsistency is a fatal legal flaw. *See, e.g.*, *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2126 (2016) ("[A]n '[u]nexplained inconsistency' in agency policy is 'a reason for holding an interpretation to be an arbitrary and capricious change from agency practice.'" (second alteration in original) (quoting *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 981 (2005))).

The Commission similarly fails to reconcile its current position with the agency's conclusion from 2007 that the tacking provision for convertible securities is *consistent* with the intent of Rule 144. *See* 72 Fed. Reg. at 71,555–56. Again, like the Commission's former Chief Economist, SPCC is "not aware of any new evidence developed since 2007 that is capable of refuting the views of the 2007 Commission." Overdahl Report 8–9. Indeed, for the last half-century, the Commission has recognized that Rule 144 adequately "prevent[s] the private placement of convertible senior securities from being employed as a device for the creation of interstate public markets in unregistered common stock." *Disclosure to Investors: A Reappraisal of Federal Administrative Practices Under the 1933 and 1934 Acts* (*the Wheat Report*) 237 (1969), *available at* https://tinyurl.com/7hdamfzb; *see also* Definition of Terms "Underwriter" and "Brokers' Transactions," 37 Fed. Reg. 591, 594 (Jan. 14, 1972) ("In view of the fact that [Rule 144] covers resales of restricted convertible securities and the restricted securities issued on their conversion, Rule 155 (17 CFR 230.155) pertaining to convertible securities has been rescinded . . . .").

Third, and finally, the Commission ignores a fundamental feature of many market-adjustable convertible note deals that further undercuts any contention that the lender is really seeking to effectuate an unregistered distribution of stock as a conduit for the borrower: the notes can be—and often are—repaid in cash. *See, e.g.*, Comment of Anshu Bhatnagar, CEO, Verus Int'l, Inc. (Feb. 9, 2021) ("Raising funds through a convertible note allows us an option to pay off the note within 6 months, which we

often do."); HealthLynked Corp., Quarterly Report 26 (Form 10-Q) (Nov. 14, 2019) (paying convertible loan in cash). The Commission does not explain how a lender can have a "view to an unregistered public distribution" of stock, 86 Fed. Reg. at 5073, when it has no idea whether it will receive stock at all. The principal and interest payments on the loan may very well come via cash. The Commission does not even acknowledge this reality.

All in all, the Commission has no evidence to believe, and no rational reason to think, that lenders are acquiring market-adjustable convertible notes with a view to effectuating unregistered distributions of a borrower's stock. Because rules must be "based on some logic and evidence, not sheer speculation," the Commission has no grounds to proceed with this proposal. *Sorenson Commc'ns Inc. v. FCC*, 755 F.3d 702, 708 (D.C. Cir. 2014).

2. Regardless, The Commission Has Not Shown Any Investor Or Market Harm That Would Justify Eliminating Market-Adjustable Convertible Loans.

Even if the Commission *could* show that some lenders are acquiring market-adjustable securities with an eye towards an unregistered distribution—and it cannot show anything of the sort—the Commission has still failed to justify the sweeping change it proposes here. The Commission claims that an unregistered distribution "pose[s] the risk that [the] distribution[ ] of securities will reach the public markets without the same level of disclosure[s] and liability protections that registration provides to investors." 86 Fed. Reg. at 5067. But the Commission's problem, yet again, is that it does not

provide any evidence that securities *are* reaching the public markets without appropriate disclosures or liability protections.

To begin, the Commission "has cited *no* complaints and provided *zero* evidence of actual abuse" in the market for market-adjustable convertible securities. *Nat'l Fuel*, 468 F.3d at 843; *see also Bus. Roundtable*, 647 F.3d at 1150 ("the Commission has presented no evidence that such [activity] is ever seen in practice"). Nor do any complaints appear to even exist. In September 2020, counsel for SPCC submitted Freedom of Information Act requests to the Commission seeking any complaints from investors from 2015 to present concerning market-adjustable convertible notes:

> 1. Complaints from individual investors, or their representatives, received by the Securities and Exchange Commission's Office of Investor Education and Advocacy from 2015 to the present relating to convertible promissory notes issued by microcap (also known as small-cap or penny stock) issuers; and
>
> 2. Complaints from individual investors, or their representatives, received by the Securities and Exchange Commission's Office of Investor Advocate from 2015 to the present relating to convertible promissory notes issued by microcap (also known as small-cap or penny stock) issuers.

Letter from Barry Goldsmith, Partner, Gibson, Dunn & Crutcher LLP, to Office of FOIA Services, SEC 1 (Sept. 21, 2020) (Exhibit C). The Commission responded on December 17, 2020—just days before it announced the pending proposal, *see SEC Proposes Amendments to Rule 144 and Form 144*, SEC (Dec. 22, 2020), https://www.sec.gov/news/press-release/2020-336—releasing 60 pages of records, *see* Letter from Carrie Hyde-Michaels, FOIA Branch Chief, SEC, to Barry Goldsmith, Partner, Gibson, Dunn

& Crutcher LLP 1 (Dec. 17, 2020) (Exhibit D). Not a single document, however, has anything to do with alleged misconduct by a lender or borrower in connection with a market-adjustable convertible loan. *See* Exhibit D at 5–64. Nor do the records show any indication that any investor has failed to understand the material terms of these deals or how the deals may impact a borrower. *See id.* Given the complete lack of evidence of investor or market harm, the Commission has entirely failed to justify the need for any intervention here, much less this heavy-handed proposal.

Evidence aside, the Commission has failed to explain why additional "investor protection[s]" are needed even in theory. 86 Fed. Reg. at 5074. Start with "disclosure[s]." *Id.* at 5067. The Commission has already conditioned the Rule-144 safe harbor on the availability of "[a]dequate current public information" about the borrower. 17 C.F.R. § 230.144(c). Thus, among other things, every borrower looking to use the six-month holding period under Rule 144 must be current on "all required reports under section 13 or 15(d) of the Exchange Act . . . during the 12 months preceding [the] sale," *Id.* § 230.144(c)(1)(i), including "quarterly reports" and "annual reports" "certified . . . by independent public accountants," 15 U.S.C. § 78m(a)(2). In addition to describing this information as "[a]dequate" in Rule 144 itself, 17 C.F.R. § 230.144(c), the Commission has long encouraged investors looking to purchase unlisted shares to review "the company's quarterly reports" and "annual reports (with audited financial statements)." *Microcap Stock: A Guide for Investors*, SEC (Sept. 18, 2013), https://www.sec.gov/re-

portspubs/investor-publications/investorpubsmicrocapstockhtm.html. The Commission does not explain why this "treasure trove" of "information . . . for investors" is suddenly inadequate. *Id.*; *see* Interactive Data to Improve Financial Reporting, 73 Fed. Reg. 32,794, 32,812 n.153 (proposed June 10, 2008) (an issuer has "adequate current public information . . . if it is current in its filing of Exchange Act periodic reports"); *accord.* 72 Fed. Reg. at 71,550 ("[T]he current public information requirement . . . is important to help provide the market with adequate information regarding the issuer of the securities."); Revisions to Rules 144 and 145 to Shorten Holding Period for Affiliates and Non-Affiliates, 72 Fed. Reg. 36,822, 36,832 (proposed July 5, 2007) (making Rule 144 available to investors in former shell companies "because the reasons for prohibiting reliance on Rule 144 do not appear to be present after a reporting company has ceased to be a shell company and there is adequate disclosure in the market that would serve to protect against further abuse"). Nor does the Commission explain what additional information would have been disclosed had the transaction been registered—or why that information would have been material to investors.

Likewise, the Commission does not, and cannot, explain why additional "liability protections" are needed. 86 Fed. Reg. at 5067. It is already a violation of federal law—indeed, a felony, *see* 15 U.S.C. § 78ff(a)—to employ "any manipulative or deceptive device or contrivance" in connection with the purchase or sale of "any security," *id.* § 78j(b); *see also* 17 C.F.R. § 240.10b-5, or to make any "false or misleading" statement in a report filed with the Commission, 15 U.S.C. § 78ff(a). What more is needed? The

Commission does not say. It does not even attempt to "address whether the [existing] regulatory requirements" adequately protect investors, *Bus. Roundtable*, 647 F.3d at 1154, let alone deny that the Commission already "has adequate enforcement tools to address abuses," 72 Fed. Reg. at 71,552. *See also Am. Equity Investors Life Insurance Company v. SEC*, 613 F.3d 166, 178-79 (D.C. Cir. 2010) (agency must consider whether "the existing regime" already provides "sufficient protections"). The Commission, therefore, has no basis to speculate that subjecting market-adjustable convertible notes to registration would in any way improve investor protections. *See Bus. Roundtable*, 647 F.3d at 1154 (where, as here, an agency fails to "adequately address" the current regulatory regime, the agency cannot assess whether there is any "benefit to be had from" adding new requirements).

Once again, the Commission has no good answer to the question of what actual problem, either real or theoretical, the proposed rule is intended to solve. That is because there is none.

3. The Commission Does Not—And Cannot—Justify The Need For The Proposed Rule Based On Concerns Over Investor Dilution.

Although the Commission mentions "extreme dilution" in passing, 86 Fed. Reg. at 5067 n.30, the agency does not attempt to justify the proposed rule on this ground. Rather, it says: "We are proposing this amendment to mitigate the risk of unregistered distributions in connection with sales of market-adjustable securities." *Id.* at 5064; *see also supra* p. 17–18. This clearly has nothing to do with dilution. *See* Overdahl Report

4 ("The Commission claims that this proposed change to the holding period determination is narrowly constructed for the purpose of mitigating the risk of unregistered distributions in connection with sales of market-adjustable securities. . . . If it is true that the rule change is aimed at a broad array of perceived undesirable conduct that harms investors, then the Commission should explicitly say so and state the purpose in a way that is transparent and promotes accountability in the exercise of their rulemaking authority.").

Any suggestion that market-adjustable convertible notes lead to excessive dilution would be unfounded and untenable. As the Commission admits, the conversion discount associated with market-adjustable convertible notes "compensat[es]" the lender for the "risk" it incurs in making a convertible loan. 86 Fed. Reg. at 5074; *see* Overdahl Report 15 n.7 ("From the perspective of the lender, the level of dilution is tied to the risk faced by the lender."). And in "opting to pay back [a] loan[ ] through conversion," rather than cash, a borrower reveals that it "value[s] the cash proceeds from the loan more than [any] resulting dilution." Overdahl Report 15 n.7 For that reason, it is "market forces," not the lender or borrower acting alone, that "determine the level of dilution." The Commission, therefore, cannot reasonably conclude that any level of "dilution necessarily is excessive," without first understanding "why borrowers and lenders agree to" certain "convertible lending terms"—an analysis the Commission has not even attempted to undertake. *Id.*

If the Commission were to undertake such an analysis, it would undoubtedly find that the level of dilution is entirely appropriate—and in fact, benefits the existing shareholders. *See infra* pp. 38–42. The Commission itself acknowledges that smaller companies often turn to market-adjustable convertible notes "as a 'last resort' form of financing." 86 Fed. Reg. at 5074; *see also id.* at 5073 (similar); *id.* at 5072 (the users of market-adjustable convertible loans are often "approaching bankruptcy"); *id.* at 5074 ("these issuers have limited options to raise capital"). In these "last resort" situations, any rationale shareholder would be "willing to trade off"—as many *are* willing to trade off—some dilution "in exchange for [the borrower] not going bankrupt." Overdahl Report 15 n.7. And even in times of less distress, the level of dilution is still appropriate. As 62 CEOs and other senior officials of smaller public companies have attested, market-adjustable convertible securities provide borrowers the capital they need to "execute [their] business plans and grow [their] businesses." Comment of 62 Small Public Companies at 2 at 1. In many cases, these companies rationally prefer to trade off some short-term dilution in exchange for freeing up their cash reserves to pursue more high-value projects that increase long-term shareholder value—and thus value flexibility "to either repay the loan in cash or convert the outstanding loan into discounted shares[.]" *Id.* The Commission has not presented any evidence that smaller companies would be better off without this valuable form of financing, or that they are somehow irrational in choosing how best to "grow [their] businesses [to] increase long-term shareholder

value[.]" *Id.* The proposed rule, therefore, cannot be justified on the basis of any concerns about potential dilution, and the Commission makes no effort to do so.[10]

4. The Vast Majority Of Comments Publicly Available So Far Oppose The Proposed Rule.

Perhaps the best empirical evidence of whether the market sees any need for the proposed rule is the comments from scores of market participants *opposing* it. *See, e.g.*, Comment of 62 Small Public Companies at 1 ("As officers and directors of publicly-traded companies who have relied on these loans to grow our businesses and increase long-term shareholder value, we respectfully urge the Commission to withdraw this misguided proposal."). In similar situations, the Commission has abandoned contemplated rule changes when the evidence refutes the Commission's initial assumptions about the need for a regulation. *See, e.g.*, Asset-Backed Securities Disclosure and Registration, Securities Act Release No. 9638, Exchange Act Release No. 72,982, 2014 WL 4820167, at *90 (Sept. 4, 2014) (finding that additional disclosure requirement was not "necessary" because the Commission "did not receive any comments from investors suggesting that [such] disclosure . . . [was] necessary").

[10] The Commission cannot rationally complain about dilution without first addressing its own actions. As discussed above, *see supra* p. 5 n.1, the Commission has launched a multi-pronged assault on the convertible lending industry, raising the risks and costs faced by convertible lenders. This has necessarily resulted in higher loan prices. If the Commission were really concerned about dilution, it would try to make convertible loans *cheaper* by supporting convertible lenders, not the opposite.

The only support the proposed rule seems to have engendered amounts to no support at all. The North American Securities Administrators Association ("NASAA"), for example, cites a seventeen-year-old law review article drafted by an LL.M. student for the proposition that market-adjustable convertible loans lead to a so-called "death spiral." Comment of NASAA 3 & n.8 (Mar. 17, 2021) (citing Zachary T. Knepper, *Future-Priced Convertible Securities and the Outlook for 'Death Spiral' Securities-Fraud Litigation*, 26 Whittier L. Rev. 359 (2004)). But even a cursory review of that article reveals that it has no application to the types of transactions at issue here. The article addresses straight-up market manipulation—where the holder of a future-priced convertible security "engag[es] in massive short selling of the issuers' common stock to intentionally depress [the] price" before a conversion. 26 Whittier L. Rev. at 367. That is not only an independent violation of the securities laws that the Commission does not even mention in the proposal and could, in any event, remedy separately through its pre-existing enforcement powers; the concern addressed in the article is not even possible here, where the proposed rule deals only with *unlisted* companies, whose shares cannot be shorted. *See* Overdahl Report 12–13 (explaining that there is "no way" to take "short positions" in companies that are "not listed").

The comments of two lawyers—who work together suing convertible note lenders[11]—are equally unavailing. They purport to address a "segment of funders known as 'dilution funders,'" a term that does not appear in any case, brief, article, treatise, or administrative decision available on Westlaw. Comment of Mark Basile 1 (Mar. 16, 2021). Addressing this made-up category, the duo lets fly an onslaught of hyperbole: so-called "dilution funders," they say, are engaged in "outrageous," "toxic" (eighteen appearances), and "death-spiral[-inducing]" (four appearances) behavior. Comment of Mark Basile 2, 3, 4, 5, 6, 7; Comment of Brenda Hamilton 1, 2, 3, 4 (Feb. 15, 2021). But for all their talk, neither Ms. Hamilton nor Mr. Basile can explain *why* hundreds, if not thousands, of public companies disagree—i.e., why thousands of directors and officers have independently concluded that market-adjustable convertible securities were the best option available for obtaining the capital they needed to grow their businesses and deliver long-term shareholder value. The two commenters simply assert that these officers and directors must not be smart enough to see what Ms. Hamilton and Mr. Basile see, *see* Comment of Mark Basile 6–7; Comment of Brenda Hamilton 3; but, with respect, that insulting line of argument has no basis in reality. Neither Ms. Hamilton nor Mr. Basile cite a shred of evidence to support their contention. Nor do the pair even mention, let alone address, the state laws *requiring* directors to inform themselves

[11] *See Meet Our Team!*, Basile Law Firm P.C., https://www.thebasilelawfirm.com/meet-the-team (last visited Mar. 22, 2021).

of the material terms of the deals in which they engage. *See, e.g.*, *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 192 (Del. Ch. 2005), *aff'd*, 906 A.2d 114 (Del. 2006). Ms. Hamilton and Mr. Basile, likewise, have nothing to say about the companies, documented in the record, that have successfully used market-adjustable convertible loans to temporarily fund their operations until they could establish or regain their footing. *See, e.g.*, *supra* pp. 10–13; *infra* pp. 38–42.

Remarkably, Ms. Hamilton effectively concedes that the companies that rely on market-adjustable convertible loans have "no [other] financing" options available. Comment of Brenda Hamilton 3. She suggests that the Commission could try "more efforts" to get small public companies the capital they need, *id.*, but that is cold comfort to the scores of businesses—and the thousands of men and women who work for them—that will go bankrupt in the meantime, as the Commission works to make available whatever form of financing Ms. Hamilton would prefer.[12] Simply put, "[i]nvestors are not protected" when the Commission eliminates the only form of financing availa-

[12] Mr. Basile argues instead that small public companies already have alternative forms of financing available to them, but he never says what those forms of financing might be or explains why the scores of officers and directors commenting in this record don't seem to know either. *See* Comment of Mark Basile 6.

ble to the companies in which they invested—especially where, as here, those companies had publicly "announced" that they would rely on such funding and the investors invested in full reliance on that understanding. *Id.* at 4.[13]

B. The Proposed Rule Cannot Be Squared With The Commission's Own Longstanding Commitment To Promoting Capital Formation

Besides being wholly unnecessary, the proposed rule is antithetical to the Commission's own longstanding commitment to promoting capital formation, particularly for smaller public companies. *See, e.g.*, *About the SEC*, https://www.sec.gov/about.shtml (last visited Mar. 19, 2021) (recognizing that part of the Commission's "mission" is to "facilitate capital formation"); Martha Miller, Advocate for Small Business Capital Formation, SEC, Bolstering Capital Formation: The Third Leg of the SEC's Mission (Apr. 8, 2019), https://www.sec.gov/news/speech/miller-bolstering-capital-formation-040819 ("By facilitating capital formation and the generation of new companies, investors realize expanded opportunities to invest and create wealth, and markets benefit from diverse companies."). Such "an '[u]nexplained inconsistency' in

[13] Ms. Hamilton's claim that investors do not understand convertible notes because the investors are "unsophisticated" is equally unsupported by the record. *See* Comment of Brenda Hamilton 4. It is also fundamentally inconsistent with the Commission's mission: public disclosure. If investors really cannot understand the terms of deals that are publicly disclosed in a company's financial reports, then the entire premise of this nation's securities laws is wrong. That is simply not the case. There is no reason for the Commission to abandon its near-century long commitment to treating the American people like adults—assuming that if accurate information is timely disclosed, the people can decide for themselves what to do with their money.

agency policy is 'a reason for holding an interpretation to be an arbitrary and capricious change from agency practice.'" *Encino Motorcars*, 136 S. Ct. at 2126.

The Commission insists, over and over again, that the proposed rule is necessary to enforce "one of the key premises of Rule 144, which is that holding securities at risk for an appropriate period of time prior to resale can demonstrate that the seller did not purchase the securities with a view to distribution." 86 Fed. Reg. at 5083; *see also supra* pp. 17–18. But this myopic focus on the purpose of the holding period disregards the broader objective of Rule 144—to reduce costs and restrictions on capital formation. *That* has traditionally been the SEC's primary goal. Thus, for example, when the Commission declined to exclude hedged positions from Rule-144 holding-period calculations, the agency made clear that adopting such a rule "would frustrate *our primary objectives to* streamline Rule 144 *and reduce the costs of capital for issuers*." 72 Fed. Reg. at 71,552 (emphasis added). And when the Commission twice shortened the holding period for firms to resell restricted securities (first in 1997 and again in 2007), it was to avoid "unnecessary costs … [and] unnecessary restraints on the flow of capital" by *encouraging* lenders to participate in more private securities transactions. 62 Fed. Reg. at 9250; *see id.* at 9242 ("Shorter holding periods should reduce the cost of capital. This particularly should benefit smaller companies[.]"); 72 Fed. Reg. at 36,825 ("[W]e do not want the holding period to be longer than necessary or impose any unnecessary costs or restrictions on capital formation."). Convertible lenders (among others) responded to the SEC's encouragement—yet are now being told that the capital formation they promote

(for small companies especially) comes second to the agency's new goal: to exclude these particular lenders from the Rule 144 safe harbor.

The Commission has taken a position dedicated to increasing small-business access to capital in numerous other contexts. *See, e.g.*, Notice of Proposed Exemptive Order Granting Conditional Exemption from the Broker-Dealer Registration Requirements, 85 Fed. Reg. 54,542, 64,547 (Oct. 13, 2020) (proposing exemption from broker-registration requirements to address "the perceived inability of smaller companies to engage the services of a broker-dealer to assist with opportunities to raise capital in exempt offerings"). And so has Congress, as the Commission itself has long recognized. *See, e.g.*, 15 U.S.C. § 78d(j) (establishing the Office of the Advocate for Small Business Capital Formation); Crowdfunding, 80 Fed. Reg. 71,388, 71,397 (Nov. 16, 2015) ("[W]e have considered that the primary purpose of Section 4(a)(6) [of the Securities Act], as we understand it, is to facilitate capital formation by early stage companies that might not otherwise have access to capital.").

The proposed rule inexplicably departs from the capital-formation objective that the Commission has long strived to advance. By effectively doubling the holding period for market-adjustable convertible notes to unlisted issuers, the Commission would all but guarantee that lenders would "demand a steeper upfront discount when investing in these securities," 86 Fed. Reg. at 5074, thus *increasing* the cost of capital for the smaller public companies that rely on these loans, *see id.* (borrowers continuing to seek such

loans "may raise less capital"); *see also* Overdahl Report 17 ("As the Commission recognizes, one likely result of the proposed rule change is that discounts at conversion will need to be much higher to account for the additional holding-period risk borne by the lender. If the proposed rule change is implemented, it is not clear that there will be a discount level that is viable for both lenders and borrowers. . . . The end result may be the elimination or substantial curtailment of this type of financing." (footnote omitted)). The Commission fails to justify its departure from longstanding policies favoring the promotion of capital formation for smaller companies.

C. The Proposed Rule Will Create Harmful, Counterproductive Consequences For Borrowers And Investors

By "increas[ing] the risk" faced by lenders, 86 Fed. Reg. at 5074, the proposed rule will create harmful, counterproductive consequences for borrowers and investors alike, depriving them of a critical form of financing, increasing the costs of capital, destroying long-term shareholder value, discouraging public disclosures, and making fraud more likely.

1. The Proposed Rule Will Drive Scores Of Smaller Public Companies Out Of Business.

The proposed rule will needlessly drive scores of smaller public companies out of business. The Commission itself admits that the proposed rule will "reduce the liquidity" of market-adjustable convertible notes, driving many lenders out of the market,

and thus "could prevent some unlisted issuers from obtaining financing" at all, "particularly since market-adjustable securities may constitute a 'last resort' form of financing." 86 Fed. Reg. at 5073.

That would be a death sentence for scores of smaller public companies, as many commenters have explained. *See, e.g.*, Comment of Mark L. Kay, CEO, StrikeForce Techs., Inc. (Jan. 27, 2021) ("Without these type of deals we would have not survived and thank God they existed and therefore kept us alive."); Comment of Robert Rositano Jr., CEO, Friendable, Inc. (Feb. 22, 2021) (convertible loans provide an "opportunity to stay alive when you are attempting to figure out technology, trends, customers and virtually everything that goes along with building a business"); Comment of James Donnelly, CEO, CurAegis Techs., Inc. (Feb. 5, 2021) ("Our company will not survive without this type of alternative financing."); Comment of Sri Vanamali, CEO, GEX Mgmt. (Feb. 12, 2021) ("As stated in our prior filings, our ability to continue as a viable business is highly dependent on our access to much needed working capital to fund our growth strategy. Without access to these loans, small reporting companies such as ours will find it extremely difficult to survive, especially in a pandemic fueled recession environment."); Comment of Alex K. Blankenship, President/CEO, AngioSoma, Inc. (Feb. 5, 2021) (without access to market-adjustable convertible loans "we will close the doors and write off the 5 years of investment by many people who have devoted their time and money to [our] success"); Comment of David Lee, CEO, BioSolar, Inc. (Feb. 8, 2021) ("potentially losing this valuable financing tool would mean the death sentence

to certain companies"); Comment of William E. Beifuss, Jr., President & CEO, Digital Locations, Inc. (Feb. 10, 201) ("Without these convertible loans we would absolutely not have been able to maintain our business."); Comment of Joseph E. Kurczodyna, CFO-COB, Blackstar Enter. Grp., Inc. (Feb. 3, 2021) ("Our company would not survive without this type of alternative financing.").

In no world does driving smaller companies into bankruptcy to protect their "existing shareholders" make any sense. 86 Fed. Reg. at 5074; *see also* Comment of Cameron Cox, CEO, Futureland Corp. (Mar. 11, 2021) ("[W]e need to have faith in our process and economy over against giving into fear that causes over-regulation that annihilates the very thing it is trying to protect . . . ."); Comment of Sec. Transfer Ass'n (Feb. 22, 2021) ("[The] amendment may effectively eliminate market-adjustable securities, leaving many microcap issuers without necessary funding and, therefore, injuring the very shareholders which the Commission seeks to protect by its Proposed Rule Change.").

2. For Those Companies That Survive, The Proposed Rule Will Raise The Cost Of Capital.

Restricting the ability of lenders to recoup their investment will "increase [the] risk" they face, 86 Fed. Reg. at 5074, and force them to raise the cost of capital (if not leave the market altogether). This is not in dispute. According to the Commission, the "proposed post-conversion holding period would reduce the liquidity of these investments. As a consequence, investors are likely to demand additional compensation for

providing capital through market-adjustable securities to these issuers." 86 Fed. Reg. at 5074; *accord id.* ("[W]e anticipate that the proposed amendment to Rule 144(d)(3)(ii) may also impose costs on some market participants including, but not limited to, an increase in the cost of financing and a decrease in the total access to financing for unlisted issuers."). Indeed, the whole point of shortening the Rule 144 holding period was to lower the "discount given by companies raising capital in private placements" by incentivizing lenders to increase their participation in the market while demanding smaller liquidity premiums. *See* 62. Fed. Reg. at 9242–43. And it worked. More small companies than ever are getting the capital they need at affordable rates. *See* Comment of 62 Small Public Companies. The Commission should not now hamstring the very lending it encouraged.

The Commission should not go down this route. "[D]riving up the cost of financing" for smaller public companies will "have a major negative effect on [those] businesses, resulting in the destruction of long-term shareholder value and putting some issuers out of business altogether." Comment of 62 Small Public Companies at 2; *see also* Overdahl Report 7 ("The Commission should consider the possibility that the proposed rule change will impose a high cost on developmental-stage firms whose growth prospects would be stifled if the proposed rule change is finalized and implemented."); Comment of Robert Rositano Jr., CEO, Friendable, Inc. (Feb. 22, 2021) ("[W]e have had some of our biggest successes when having started with convertible note financing, building our business or piloting a service, then ratcheting up growth to achieve future

rounds of financing at more favorable rates . . . ."). There is no reason to do this—particularly in the name of defending "shareholders." 86 Fed. Reg. at 5074; *cf.* Comment of Robert Linton (Feb. 8, 2021) ("The best way to protect the investors is to give the companies more opportunities to get hard cash investment into the companies to execute its business plan.").

The proposal to determine the eligibility for tacking by looking to a borrower's listed- or unlisted-status "at the time of conversion or exchange," 86 Fed. Reg. at 5084, as opposed to the time of the initial transaction, needlessly raises the cost of capital for listed issuers as well. If the securities of unlisted borrowers (assessed at the time of conversion) were ineligible for tacking, lenders would not loan to listed companies that were struggling and were therefore at a risk of being delisted. By failing to address this market dynamic, the Commission has created a proposed rule that will not just harm unlisted borrowers, but listed borrowers as well. Again, there is no need for this.[14]

[14] In fact, the whole reason the Commission proposes to exempt securities from listed issuers from the proposal—because the stock exchanges generally require shareholder approval for actions relating to a certain percentage of a borrower's shares—supports assessing eligibility at the time of the initial transaction. *That* is when the shareholders will grant their approval. *See id.* at 5067 n.29. A conversion of a security from a formerly listed company is no less authorized because of the delisting. The Commission inexplicably fails to consider the scenario in which a listed issuer is delisted in the time between sale of the original note and conversion and, likewise, fails to consider the impact of that scenario on the costs of the proposed rule.

3. The Proposed Rule Will Perversely Discourage Firms From Publicly Disclosing Their Financials.

The Commission frets—without evidence, *see supra* pp. 17–24—that the availability of market-adjustable convertible securities will lead to the distribution of securities that do "not have the disclosure . . . protections that registration provides." 86 Fed. Reg. at 5074. But for the actual recipients of market-adjustable convertible securities—the "low- or no-revenue" growth-stage firms, 86 Fed. Reg. at 5072—where does the Commission think these firms acquire the capital they need to hire the "independent public accountants" and attorneys needed to file and prepare their financials in the first place? 15 U.S.C. § 78m(a)(2). The Commission does not say. In reality, firms require the assistance of market-adjustable convertible loans to afford these services. *See, e.g.*, Comment of Timothy G. Dixon, President & CEO, Therapeutic Solutions Int'l, Inc. (Feb. 5, 2021) ("Had [market-adjustable convertible loans] not been available I would not have been able to advance the Company otherwise and most likely would not have been able to stay fully reporting."); *see also* Overdahl Report 9 ("I understand that some unlisted companies use the proceeds from market-adjustable convertible loans to pay their auditors. A company with no revenue and no other sources of financing will need convertible loans to fund its operations and prepare the audited financial statements."). Without these loans, many fewer firms will be able to file the very disclosures the Commission finds so important. That will not serve investors or borrowers well—and makes little sense for an agency that has long prided itself on being "a disclosure-based

agency." Paul. S. Atkins, Comm'r, U.S. SEC, Recent Experience with Corporate Governance in the USA (June 26, 2003), *available at* 2003 WL 21515877, at *5.

Not only will fewer firms be *able* to publicly file financial statements, the proposed rule will discourage the firms that can from doing so, causing them to potentially deregister from the Exchange Act's reporting requirements. Again, filing financial disclosures is not cheap. Nor is it generally required of unregistered companies. The main reason many of these firms register to file financial disclosures at all is to preserve their ability to access market-adjustable convertible notes if they need to. *See* 17 C.F.R. § 230.144(c)(1)(i) (conditioning the use of Rule 144 on, among other things, current financial disclosures for the preceding 12 months); *see also* Overdahl Report 9 ("I understand that many companies file their 8-Ks and 10-Qs to be able to use convertible loans."); *accord* Comment of Sec. Transfer Ass'n (Feb. 22, 2021) ("[T]he ability to obtain financing through market-adjustable securities . . . encourage[s] microcap issuers to satisfy the reporting requirements of the Exchange Act."). As a result, if the proposed rule curtails "market-adjustable convertible debt for unlisted companies," "fewer companies" will have an incentive to "be filing 8-K and 10-Q disclosures." Overdahl Report 9. That result is more than a little hard to square "with the Commission's longstanding desire for having more disclosure available to the investing public." *Id.*

4. The Proposed Rule Will Harm Women- And Minority-Owned Businesses.

Members of the Commission have recognized that restricting access to capital disproportionately impacts small businesses owned by women and minorities. *See, e.g.*, Caroline A. Crenshaw, Comm'r, SEC, Remarks at the Meeting of the Small Business Capital Advisory Committee (Jan. 29, 2021), https://www.sec.gov/news/public-statement/crenshaw-remarks-sbcfac-meeting-012921; Allison Herren Lee, Comm'r, SEC, Remarks to the Small Business Capital Formation Advisory Committee (Aug. 4, 2020), https://www.sec.gov/news/public-statement/lee-remarks-sbcfac-meeting-080420. Accordingly, in other contexts, the Commission has lifted restrictions on capital formation for the express purpose of helping "underrepresented founders, such as women and minorities," gain access to the funding they need to grow their businesses. Notice of Proposed Exemptive Order Granting Conditional Exemption from the Broker Registration Requirements of Section 15(a), 85 Fed. Reg. 64,542, 64,543 & n.13 (Oct. 13, 2020).

This rulemaking is a step in the wrong direction. In a world where women and minorities have difficulty accessing capital, *see* Office of the Advocate for Small Business Capital Formation, Annual Report for Fiscal Year 2019, at 26, 30 (2019), the last thing the Commission should be doing is discouraging the use of one of the only sources—if not the only source—of capital for many smaller public companies, *see, e.g.*, Comment of Shannon Masjedi, CEO, Pacific Ventures Grp., Inc. (Jan. 25, 2021); Comment of

Hope Stone, CFO, Ameramex Int'l Inc. (Feb. 9, 2021); Comment of Ashnu Bhatnagar, CEO, Verus Int'l, Inc. (Feb. 9, 2021); Comment of Sri Vanamali, CEO, GEX Mgmt. (Feb. 12, 2021); Comment of 62 Small Public Companies *passim*; *see also* Comment of Robert Blair, CEO, LGBTQ Loyalty Holdings, Inc. (Feb. 4, 2021) (without market-adjustable convertible notes, "[m]y company would have never had the ability to make history with our NYSE LGBTQ100 Index fund which recognizes the best 100 companies in the S&P 500 that support advancing equality best practices").

5. The Proposed Rule Will Make Fraud More Likely.

Far from protecting investors, the proposed rule will make fraud *more* likely. As detailed above (*see supra* pp. 43–44), the proposed rule will result in fewer companies filing financial disclosures—one of the main tools investors can use to protect themselves from fraud. *See Publication or Submission of Quotations Without Specified Information*, Exchange Act Release No. 39,670, 1998 WL 63592, at *2 (Feb. 17, 1998) ("Microcap fraud frequently involves issuers for which public information is limited, especially when issuers are not subject to reporting requirements. Without information, it is difficult for investors, securities professionals, and others to evaluate the risks presented by microcap securities.").

In addition, outstanding convertible debt "could prevent . . . pump and dump schemes." Overdahl Report 5 n.3. As the Commission is aware, "pump-and-dump scheme[s] often involve[ ] thinly traded securit[ies]," typically issued by unlisted issuers. *Publication or Submission of Quotations Without Specified Information*, Securities Act Release

No. 10,842, Exchange Act Release No. 89,891, 2020 WL 5763379, *53 (Sept. 16, 2020). In such a scheme, a fraudster "pumps up" buying interest in a stock he owns, causing the stock's price to rise; then, the fraudster sells his shares at an inflated price. Convertible debt, however, significantly undermines the fraudster's ability to hype a stock. As the stock's price starts to rise, a convertible lender with outstanding debt will have an incentive to "convert and sell," thereby "keeping the price in proper alignment with its fundamental value." Overdahl Report 5 n.3. The Commission fails to consider this very real market dynamic.

6. Adopting The Proposed Rule During An Ongoing Global Pandemic Is Particularly Dangerous.

"COVID-19 has had a disproportionate negative impact on small businesses," with "more than 50% . . . fac[ing] immediate or near-term risks." Jay Clayton, Chairman, SEC, Remarks to the Annual Government-Business Form on Small Business Capital Formation (June 18, 2020). Accordingly, "preserving the flows of credit and capital" to small businesses has been the Commission's "overriding" priority. Jay Clayton, Chairman, SEC, The Deep and Essential Connections Among Markets, Businesses, and Workers and the Importance of Maintaining Those Connections in Our Fight Against COVID-19 (Mar. 24, 2020). Thus, every Commissioner has committed to addressing the "challenges small businesses face in raising capital," Hester M. Peirce, Comm'r, SEC, Remarks at the Virtual Small Business Forum (June 18, 2020), by "work[ing] across regulatory channels . . . to facilitate capital formation," Allison Herren Lee,

Comm'r, SEC, Remarks at the 39th Annual Government-Business Forum on Small Business Capital Formation (June 18, 2020). As Commissioner Roisman put it, "it is certainly our jobs to try." Elad L. Roisman, Comm'r, SEC, Remarks at the Annual Government-Business Forum on Small Business Capital Formation (June 18, 2020). Or as Commissioner Crenshaw said, "I hope [the Small Business Capital Formation Advisory Committee] will be able to devote some time . . . to thinking about what additional steps the Commission might take to help businesses get back up and running as we enter the next phase of the pandemic." Caroline A. Crenshaw, Comm'r, SEC, Remarks at the Meeting of the Small Business Capital Formation Advisory Committee (Jan. 29, 2021).

While reasonable minds might disagree about many of the proposals to get small businesses back up and running, there should be one area of common ground: taking away the only source of financing for scores of small businesses—one that has existed for decades—during an ongoing global pandemic is a terrible idea. *See, e.g.*, Comment of Timothy Hassett, Chairman & CEO, Cool Techs., Inc. (Feb. 5, 2021) ("I can unequivocally state that COVID has significantly impacted international financing by lengthening the timeline to close and receive funds by many months. The capital received from convertible lenders has kept us operating in the short term."); Comment of William E. Beifuss, Jr., President & CEO, Digital Locations, Inc. (Feb. 10, 2021) ("Having access to Market-adjustable Convertible Loans has been and will continue to be a vital source of financing for our business. This has been especially the case during

this critical and economically disabling COVID-19 pandemic."). There is never a good time to take away such a vital financing tool, but if there ever were such a time, now is not it.

D. The Commission Has Failed To Give Adequate Consideration To Reasonable And Less Restrictive Alternatives

The Proposing Release failed to consider the obvious alternative to the proposed rule: enhanced disclosure requirements. It should have done so because the SEC "is a disclosure-based agency, not a merit regulator." Atkins, Recent Experience with Corporate Governance, 2003 WL 21515877, at *5. In recognition of this role, Congress expressly gave the Commission the power to require enhanced disclosures, an alternative that is consistent with the proper role of the Commission. *See* 15 U.S.C. § 78o(n)(1). Indeed, the Commission typically turns to disclosure to address investor-protection concerns. *See, e.g.*, 17 C.F.R. §§ 229.10–229.1305.

Despite worrying that investors "would not have the disclosure . . . that registration provides," 86 Fed. Reg. at 5074, the Commission does not once consider requiring whatever disclosure it thinks is missing. Again, the Commission already conditions Rule 144 on the availability of "[a]dequate current public information" about the borrower, 17 C.F.R. § 230.144(c), including "all required reports under section 13 or 15(d) of the Exchange Act . . . during the 12 months preceding [the] sale," *id.* § 230.144(c)(1)(i). If there is more information that investors need, the Commission should say what it is and require firms to disclose it.

In addition, even though seemingly all market-adjustable convertible loans are already "publicly disclosed at the time the loans are made," Comment of 62 Small Public Companies at 2, the Commission could expressly mandate such disclosure—on the off-chance a few firms are not already doing it. *See* Overdahl Report 16 ("Another alternative the Commission could consider is amending their disclosure regulations to make it mandatory for companies to file 8-K disclosures if they receive convertible financing."). Alternatively, the Commission could enforce the disclosure requirements that already exist, which the Commission itself has said *requires* borrowers to disclose market-adjustable convertible notes. *See, e.g.*, *In re Elray Res., Inc.*, 2016 WL 5571631, at *2 (Sept. 30, 2016).

The Commission's failure to even mention additional disclosure by issuers as a possible alternative to the proposed rule is baffling. If disclosing the terms of a market-adjustable convertible note is not sufficiently informative for investors, then why did the Commission launch an enforcement initiative against borrowers that failed to disclose the terms of market-adjustable convertible notes? *See, e.g.*, *In re Elray*, 2016 WL 5571631. The Commission should explain this—seemingly inexplicable—discrepancy.

The Commission also failed to consider other reasonable, less restrictive alternatives to the proposed rule. The attached report of Jim Overdahl identifies numerous straightforward alternative approaches, such as requiring mandatory board approval of the terms of convertible debt or devoting more enforcement resources to rooting out cases of actual fraud. *See* Overdahl Report 16. Yet the Commission failed even to

mention these less burdensome options. Nor did the Commission give serious consideration to eliminating tacking only for non-reporting companies. 86 Fed. Reg. at 5074; *see* Comment of Sec. Transfer Ass'n (Feb. 22, 2021) (proposing that the SEC consider "eliminat[ing] tacking for market-adjustable securities *only* with respect to non-reporting issuers," which would "minimiz[e] the risk to the public of unregistered distribution of securities" while still "permitting certain reporting companies to avail themselves of financing through market-adjustable securities" (emphasis added)). The Commission simply observed that "[s]uch an alternative would create an asymmetry within the subset of unlisted issuers," 86 Fed. Reg. at 5074, but never explained why such an asymmetry would not be appropriate. In light of the already significant differences in the way the Commission treats reporting and non-reporting companies, *see, e.g.*, 17 C.F.R. § 230.144(d)(1)(i), (ii), a different holding-period regime would seem appropriate. The Commission's failure to meaningfully consider these alternatives was error because, as the Commission's "own guidance details," the Commission must "identify and discuss reasonable potential alternatives" before attempting to impose new and burdensome regulations. Current Guidance on Economic Analysis in SEC Rulemakings 8 (Mar. 16, 2012), https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

If the Commission were to consider these alternatives—as it must, especially now that SPCC has pointed them out on the record—it is not clear on what grounds

the Commission could reject them. Take mandatory board approval of market-adjustable convertible loans. The Commission already claims that its proposed rule need not apply to firms listed on stock exchanges because stock exchange rules already "require[e] shareholder approval of an issuance of 20 percent or more of a company's common stock." 86 Fed. Reg. at 5067 & n.29. But why would board approval not similarly address the Commission's concerns? To begin, a corporate board is elected by the shareholders and has a fiduciary duty to represent the shareholders' best interests. The Commission does not suggest that boards are unable or unwilling to faithfully carry out that responsibility in the context of market-adjustable convertible notes. Nor would any such suggestion be tenable on the record here. The boards of directors of smaller public companies "often own a large percentage of the companies' stock." Comment of 62 Small Public Companies at 2. As the CEOs and other top officials of 62 smaller public companies explain, "[i]t would make no sense for officers and directors to approve taking out convertible loans that harm the long-term value of their *own* shares as well as those of other shareholders." *Id.*

E. The Commission Must Also Consider The Substantial Reliance Interests Engendered By The Existing Regulatory Regime.

The Commission must also consider the reliance interests of the many constituencies who will be harmed by the proposed rule. *See Encino Motorcars*, 136 S. Ct. at 2125–27. Those constituencies include lenders and borrowers (and their investors),

who have all structured their affairs based on the availability of market-adjustable convertible loans.

1. The Commission Did Not Adequately Consider The Reliance Interests Of Market Participants And Others.

The Commission gave short shrift to the reliance interests of the hundreds of smaller public companies which, if the proposed rule is adopted, may no longer be able to borrow money via market-adjustable convertible loans. Many smaller companies are currently relying on these loans to fund their capital needs, *see supra* pp. 10–12, 38–42, especially during the ongoing pandemic, *see supra* pp. 47–49. And others, while not using convertible loans presently, have structured their operations on the understanding that these loans will be available when they need them—whether to quickly plug a need for emergency funding, *see, e.g.*, Comment of Brad J. Moynes, CEO, Digatrade Fin. Corp. (Feb. 4, 2021) (these loans are "an efficient method for small businesses to access working capital quickly"); Comment of Hope Stone, CFO, Hamre Equipment (Feb. 9, 2021) (similar), or to provide the capital needed to seize a new, developing business opportunity, *see, e.g.*, Comment of Robert Rositano Jr., CEO, Friendable, Inc. (Feb. 22, 2021) (using convertible loans to "pivot" to new "technology, trends, customers"). *See also, e.g.*, Comment of Eric Blue, Bridgeway Nat'l Corp. (Feb. 5, 2021) ("These convertible loans have been and we envision will continue to be in the near term essential to our ability to fund both working capital and growth."); Comment of Sri Vanamali, CEO, GEX Mgmt. (Feb. 12, 2021) ("Market adjustable convertible notes have been

historically a key component of our financing source and one that we have reliably tapped into over the years and plan to continue to do so in the future."). The Commission should not pull the rug out from under these firms' reasonable and settled expectations.

The Commission also failed to consider the reliance interests of the workers, customers, vendors, and others who rely on companies that are still in business and expanding due to the availability of market-adjustable convertible loans. Their interests count as well. *See, e.g.*, Comment of Anshu Bhatnagar, CEO, Verus Int'l, Inc. (Feb. 9, 2021) ("Furthermore, the speed [at] which we can receive funds from a convertible note is critical as we have over one hundred employees and that can be a decision on whether to lay off employees."); Overdahl Report 6–7 ("The Commission should also consider the related impact of bankruptcy on jobs lost, including job growth foregone for the subset of companies that in the future would have become successful listed companies."). And so, too, do the interests of convertible lenders themselves, who were unmistakably *encouraged* by the SEC's 30-plus years of deregulatory rulemaking to increase their participation in private transactions. *See, e.g.*, 62 Fed. Reg. at 9243 (shortening the holding period from two years to one year); 72 Fed. Reg. at 71,564 (shortening the holding period from one year to six months). The SEC's turnabout now is inappropriate—but even worse in light of the fact that lenders were *not even part of* the SEC's reliance calculus, when they are the very party regulated by its unprecedented proposal.

The Commission also has failed to account for the reasonable expectations of the very investors who the Commission purports to protect—who undoubtedly have invested in smaller companies with the understanding that these companies will be able to tap what is often the only source of financing available to them. The Commission itself warns investors investing in microcap stocks to "[r]ead carefully the most recent reports the company has filed with the SEC and [to] pay attention to the company's financial statements." *Microcap Stock: A Guide for Investors*, *supra*. Many investors have done just that. And in reviewing those "prior filings," they would have understood that many companies' "ability to continue as a viable business is highly dependent on [their] access to" market-adjustable convertible loans. Comment of Sri Vanamali, CEO, GEX Mgmt. (Feb. 12, 2021). Yanking those loans away now will do nothing but hurt the many companies that rely on them and rock the expectations of the investors who made their investment decisions with the understanding that market-adjustable convertible loans would be available.

The Commission cannot shrug off these concerns by asserting that some companies will find alternative (albeit more expensive) forms of financing. Market-adjustable convertible loans are often the *only* form of financing available for smaller public companies. So make no mistake: the Commission's proposed rule, if adopted, will bankrupt scores of smaller companies, tossing countless workers into unemployment during a global pandemic, and obliterate the investments of the ordinary Americans who have purchased the shares of those companies.

2. Applying The Proposed Rule To Existing Market-Adjustable Convertible Note Deals Would Be Arbitrary And Capricious.

Finally, if the Commission were to issue a final rule—and it should not, for the reasons we have given—the agency must not apply the rule to market-adjustable convertible notes that were acquired before the rule's effective date. When a "prior policy has engendered serious reliance interests," those interests "must be taken into account." *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (citing *Smiley v. Citibank (S.D.), N.A.*, 517 U.S. 735, 742 (1996)). "It would be arbitrary or capricious to ignore such matters." *Id.*

Here, the Commission has not justified—and cannot justify—applying a transformational regulatory amendment to deals that were negotiated and executed in full reliance on a longstanding, pre-existing regulatory regime. There is no doubt that currently existing deals would have been priced differently—and may not have been executed at all—had the contracting parties known that the Commission would have required the "holding period . . . to begin upon conversion or exchange." 86 Fed. Reg. at 5073. The Commission itself concedes that under its current proposal, market-adjustable convertible note deals would have been priced differently to compensate lenders for the "increase in risk." *Id.* at 5074. It is fundamentally unfair to shift enormous economic risk onto private parties that have structured their affairs in reliance on the Commission's longstanding rules. *Cf. Hirschey v. FERC*, 701 F.2d 215, 219 (D.C. Cir. 1983) (harboring "no doubt but that the equities favor" a party who had "detrimental[ly]

reli[ed] on the grant of [an] exemption once it became final"). In all events, therefore, pre-existing notes must be exempted from any new regulatory regime the Commission adopts.[15]

In fact, if the Commission applies the proposed rule to previously executed deals, it may cause borrowers to go into default, imposing further costs on the small businesses the Commission purports to be helping. The terms of convertible loans often require the borrower to deliver upon conversion shares of common stock that are eligible for resale. Under the proposed rule, that would not be possible at the six-month conversion date, possibly triggering a default. There is no need for the Commission to subject borrowers (and the market) to this risk and uncertainty.

II. The Proposed Rule Is Unlawful For Additional Reasons

The proposed rule independently runs afoul of other statutory restrictions on the Commission's rulemaking authority. The proposal cannot be implemented because: (A) it will not promote the required statutory objectives of efficiency, competition, and capital formation; (B) its costs outweigh its benefits; and (C) the Commission has not given the public a meaningful opportunity to participate in this rulemaking.

[15] Alternatively, the Commission could make any rule change effective one year after a final rule is published in the *Federal Register*. That time will allow most lenders to close out their existing deals, without unfairly exposing them to risk they never anticipated or prepared for.

A. The Proposed Rule Will Reduce Efficiency, Stifle Competition, And Deter Capital Formation.

The Exchange Act and the Securities Act require the Commission to determine whether a rulemaking will "promote efficiency, competition, and capital formation." 15 U.S.C. §§ 78c(f), 77b(b); *see* 86 Fed. Reg. at 5072 n.65. The Exchange Act additionally prohibits any rulemaking that "would impose a burden on competition not necessary or appropriate in furtherance of the purposes" of the statute. 15 U.S.C. § 78w(a)(2); *see* 86 Fed. Reg. at 5072 n.65. Neglecting these statutory duties also constitutes an arbitrary and capricious failure to consider statutorily required factors. *See Bus. Roundtable*, 647 F.3d at 1148 (citing *Pub. Citizen v. Fed. Motor Carrier Safety Admin.*, 374 F.3d 1209, 1216 (D.C. Cir. 2004)).

To fulfill those responsibilities, the Commission must produce a reasoned evaluation of the costs and ramifications of a new proposed regulation. An "estimate" of costs, the United States Court of Appeals for the District of Columbia Circuit has explained,

> would be pertinent to [the Commission's] assessment of the effect the condition would have upon efficiency and competition, if not upon capital formation . . . . [U]ncertainty may limit what the Commission can do, but it does not excuse the Commission from its statutory obligation to do what it can to apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation before it decides whether to adopt the measure.

Chamber of Commerce v. SEC, 412 F.3d 133, 144 (D.C. Cir. 2005).

The Commission's superficial discussion of efficiency, competition, and capital formation, *see* 86 Fed. Reg. at 5074, indicates that the Commission is dramatically underestimating the harmful "economic consequences" of its proposed rule. As we explain below—and as we will describe in addressing the cost-benefit analysis in Part II.B—the proposed rule will raise costs along several dimensions that the Commission has failed to account for. The result will be the imposition of an undue burden on capital formation that will provide few if any offsetting benefits to investors.

It bears emphasis that the Commission's failure to address these aspects of efficiency, competition, and capital formation in the Proposing Release meaningfully constrains the Commission's manner of addressing them later in this rulemaking. Under the notice-and-comment requirements of the APA, an agency cannot develop a rule using secret data, which means that "the most critical factual material that is used to support the agency's position" must be "made public in the proceeding and exposed to refutation." *Chamber of Commerce v. SEC*, 443 F.3d 890, 900 (D.C. Cir. 2006) (internal quotation marks omitted). The "information that must be revealed for public evaluation" includes "the technical studies and data upon which the agency relies." *Id.* at 899 (internal quotation marks omitted). Consequently, the Commission is foreclosed from "extensive reliance upon extra-record materials in arriving at its cost estimates" concerning the proposed rule, unless it provides "further opportunity for comment" on those materials and the Commission's analysis of them. *Id.* at 901. In other words, if

the Commission decides to adopt the proposed rule, and it relies on new data to support its analysis of efficiency, competition, and capital formation, then the Commission must re-open the comment period so as to avoid violating the requirements of 5 U.S.C. § 553(c).

1. The Commission's Concession That It Cannot "Readily Observ[e] Or Reliably Quantif[y]" The Anticipated Effects On Efficiency, Competition, And Capital Formation Is Fatal.

A cross-cutting flaw in the Commission's analysis of efficiency, competition, and capital formation is its *conceded abandonment* of any attempt to reasonably evaluate the effects of its proposed rules. The Commission frankly admits, at the outset, that it is unable to "reliably quantif[y]" the "total effects on efficiency and competition." 86 Fed. Reg. at 5074. That should have been the end of this rulemaking.

The Commission violates its statutory duties where—as it *admits* here—"it did nothing to estimate and quantify the costs it expected companies to incur . . . . Because the agency failed to 'make tough choices about which of the competing estimates is most plausible, [or] to hazard a guess as to which is correct,' . . . it neglected its statutory obligation to assess the economic consequences of its rule." *Bus. Roundtable*, 647 F.3d at 1150 (alteration in original) (quoting *Pub. Citizen*, 374 F.3d 1221); *see also id.* at 1148–49 ("[T]he Commission acted arbitrarily and capriciously for having failed once again . . . adequately to assess the economic effects of a new rule. Here the Commission inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be

quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters.").

The Commission's excuse for not attempting any effects-based analysis is that "[b]ecause total effects on efficiency and competition would aggregate across issuers, industries, and markets that the proposed changes may impact differentially, we anticipate that the unique impact of the amendment to the holding period requirements would not be readily observable or reliably quantified." 86 Fed. Reg. at 5074. This makes no sense. The Commission does not explain what "markets" would be impacted "differentially" or why these differential impacts would prevent the Commission from even "hazard[ing] a guess" as to the effect of the proposed rule. *Bus. Roundtable*, 647 F.3d at 1150. Nor does the Commission explain why it is unable, as the agency's former Chief Economist recommends, "to assess the impact of the 2007 rule changes because they are a mirror image guide to assessing the likely economic impact of the current proposed rule change." Overdahl Report 3. Forget *quantifying* the effects—as the Commission is required to do—the agency cannot even say whether the proposed rule will improve efficiency, competition, or capital formation *at all*. And the agency, likewise, reaches no conclusion whether the proposal will benefit "existing shareholders"; the "net effect," the Commission admits, is "unclear." 86 Fed. Reg. at 5074.

If the Commission cannot even decide *whether* its massive new regulatory initiative would further the required statutory objectives, it should stay its hand. This conceded failing alone requires that the proposal be abandoned. This fundamental flaw

also produces more specific problems with the Commission's "qualitative" analysis of efficiency, competition, and capital formation and the related cost-benefit analysis, as discussed below.

2. The Commission's Failure To Assess The Existing State Of Efficiency, Competition, And Capital Formation Is Also Fatal.

Separately, the Commission's analysis of efficiency, competition, and capital formation fails because it entirely neglects to "make any finding on the existing level of [efficiency, competition, and capital formation] in the marketplace." *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 178 (D.C. Cir. 2010). "The SEC could not accurately assess any potential increase or decrease" in efficiency, for example, "because it did not assess the baseline level" under the existing regime, making it impossible to make a reasoned assessment of any change. *Id.*

Here, the Commission's analysis of efficiency, competition, and capital formation makes no findings at all as to the existing state of each factor. While the Commission makes a brief reference to the "Economic Baseline" of the convertible-note market, the agency's two-paragraph high-level sketch does not even mention, let alone analyze, the current state of efficiency, competition, and capital formation. 86 Fed. Reg. at 5073. Moreover, the Commission's own requests for comments reveal its lack of knowledge regarding the exact question that Congress has tasked the Commission with answering. *See id.* at 5074 ("What is the impact of the proposed rule on efficiency,

competition, and capital formation?"); *see also id.* ("We invite commenters to submit data or studies that would facilitate estimating such effects.").

3. The Commission's Analysis Of The Specific Factors Of Efficiency, Competition, And Capital Formation Is Otherwise Inadequate.

Moving to the specific factors of the analysis of efficiency, competition, and capital formation, the Commission fares no better.

a) The Commission Concededly Failed To Find The Proposed Rule Will Improve Efficiency.

To begin, the Commission concededly did not find that the rule will improve *efficiency* even in loose, "qualitative" terms. 86 Fed. Reg. at 5072. The word "efficiency" appears once—outside of the title—in the section on "Effects on Efficiency, Competition, and Capital Formation." *Id.* at 5074. In that fleeting reference, the Commission states only that it cannot "reliably quantif[y]" the anticipated effects on "efficiency." *Id.* That is it. To put it mildly, admitting that the agency cannot quantify the effects on efficiency—and saying nothing else on the topic—is not adequately "consider[ing]" "whether the action *will* promote efficiency." 15 U.S.C. §§ 77b(b), 78c(f) (emphasis added).

The only other time the Commission even mentions "efficiency" in connection with the proposed amendment to Rule 144 is in a discussion of "Broad Economic Considerations." 86 Fed. Reg. at 5072. And even there, the Commission cannot so much

as hazard a guess. After reviewing economic articles on convertible financing in general—none of which, Overdahl notes, "directly relate[ ] to the type of convertible loans at issue in the proposed rule change," Overdahl Report 15—the Commission states that it "is ambiguous . . . whether [convertible] investments represent efficient allocations of external financing." 86 Fed. Reg. at 5072. Yet again, that non-determination is wholly insufficient. The Commission has totally abdicated its duty to estimate the overall effect of the proposed rule on efficiency, in even the loosest, most qualitative terms. By its own admission, the Commission is flying blind.

Had the Commission attempted to fulfill its statutory responsibilities before proposing to eliminate a vital source of financing for smaller public companies, the agency would have learned that market-adjustable convertible notes promote efficiency. The comments of numerous borrowers in this rulemaking provide direct, empirical evidence that market-adjustable convertible loans are "an efficient method for small businesses to access working capital quickly." Comment of Brad J. Moynes, CEO, Digatrade Fin. Corp. (Feb. 4, 2021).

b) The Proposed Rule Will Stifle Competition.

As with efficiency, the Commission failed to make even the basic finding that the proposed rule will promote competition. The Commission's competition-analysis reads in its entirety: "Because total effects on . . . competition would aggregate across issuers, industries, and markets that the proposed changes may impact differentially, we anticipate that the unique impact of the amendment to the holding period requirements

would not be readily observable or reliably quantified." 86 Fed. Reg. at 5074. Aside from acknowledging the statutory requirement to consider competition, that is the only reference to competition in the entire proposal. There is no court in the country that would uphold a rule promulgated under that "analysis."

The reason the Commission barely mentions competition is likely because there is no doubt that the proposed rule would stifle it. The Commission acknowledges that the rule will drive many lenders out of the market; will remove a source of financing for smaller companies; will disproportionately burden those same smaller companies; and will run many of them right out of business. *See* 86 Fed. Reg. at 5073; *supra* pp. 38–42, –45–46. That is a competition train wreck.

c) The Commission Concededly Failed To Find That The Proposed Rule Will Promote Capital Formation.

With respect to capital formation, the Commission's top-line conclusion is the enigmatic (and tautological) statement that "the proposed amendment is likely to have an effect on capital formation." 86 Fed. Reg. at 5074. Yes, but what *kind* of effect? Retreating from this stratospheric level of abstraction, the Commission concedes the more specific point that under the proposed rule, smaller companies "may raise less capital." *Id.*

As with the other statutory factors, the Commission failed to make even the basic finding that the proposed rule will promote capital formation. Offering only one scant paragraph of purported analysis, the Commission mentions various contrary potential

effects, possibilities, and contingencies of unspecified magnitude and likelihood—and then throws up its hands. On the one hand, the Commission admits the "costs" of marketable-adjustable loans may "increase," forcing smaller companies to "raise less capital." 86 Fed. Reg. at 5074. On the other hand, according to the Commission, under the proposed rule, investors "*may* be more willing to increase their investments" in smaller public companies, at least "[t]o the extent that" certain hypothetical factual situations (which the Commission does not even attempt to prove) come about. *Id.* (emphasis added).

In fact, however, the balance sheet of the proposed rule runs entirely *against* capital formation. The Commission identifies only *two* possible aspects of its rule as promoting capital formation. Neither passes muster. *First*, the Commission states that "[t]o the extent that the sales of underlying securities into the broader market following a conversion of market-adjustable securities constitute a distribution"—a contention the Commission does not attempt to prove—"the proposed amendment is likely to reduce the number of instances in which existing shareholders and new investors would not have the disclosure and liability protections that registration provides." 86 Fed. Reg. at 5074. This contention, however, has "no basis beyond mere speculation." *Bus. Roundtable*, 647 F.3d at 1150. The "Commission has presented no evidence" that such unregistered distributions have "ever [been] seen in practice." *Id.* Nor does the Commission identify any disclosures or liability protections that are lacking under the current regime. *See supra* pp. 24–28. Moreover, the Commission "could not accurately assess

any potential increase or decrease" in capital formation arising from a supposed enhancement of disclosures or liability protections "because it did not assess the baseline level of" disclosures or liability protections "under [pre-existing] law." *Am. Equity*, 613 F.3d at 178.

The Commission's *second* suggestion—that investors "may be more willing to increase their investments in the issuer because they are less concerned about potential dilution of their holdings"—is equally unavailing. 86 Fed. Reg. at 5074. To begin, the Commission does not offer any evidence that investors *in microcap companies* are "concerned about potential dilution of their holdings." *Id.* Given that market-adjustable convertible loans are often the only source of financing for such companies, and that these types of loans are publicly disclosed in thousands of filings on the Commission's own EDGAR database, there is little reason to believe that investors in microcap companies are concerned about potential dilution arising from convertible notes. In fact, per standard industry guidance, many retail investors commit small sums to investments in microcap companies hoping for a large reward if the venture is successful. *See* Dan Moskowitz, *The Risks and Rewards of Penny Stocks*, Investopedia (May 22, 2019), https://www.investopedia.com/updates/penny-stocks-risks-rewards/ ("limit[ ] your holdings"); *see also* Overdahl Report 10 ("[T]he Commission should seek information about . . . [whether] retail investors commit[ ] small sums to investments they know are risky but may pay off if the venture is successful"). In those situations, investors are

more than willing to "trade off" a little dilution for an opportunity for their investment to thrive. Overdahl Report 15 n.7.

More fundamentally, the Commission's speculation—that investors "may" be willing to invest more in smaller public companies if there are no market-adjustable convertible loans, 86 Fed. Reg. at 5074—completely disregards the other *undisputed* impact of the rule: it will drive scores of smaller public companies out of business since there often are no alternative sources of financing for these companies. *See supra* pp. 38–40. By taking the "last resort" form of financing off the table, the Commission's proposal will necessarily condemn many of the recipients of market-adjustable convertible notes to bankruptcy. The resulting increased bankruptcy risk associated with smaller public companies will make investors much less willing to invest in them. That will not *improve* capital formation.

The proposed rule will have other negative impacts on capital formation that the Commission did not consider. For example, the Commission fails to account for the risk that its restrictions will prevent or discourage new and innovative companies from going public at all, or prevent them from growing to become "large, listed companies." Overdahl Report 7. Take just one example: FuboTV. As discussed above, *see supra* p. 11–12, between 2017 and 2018, FuboTV relied on a series of convertible notes to fund its operations during a period of limited revenue. Today, FuboTV has not only paid back its convertible loans (in cash); it is publicly listed on the New York Stock Exchange and is valued at over $600 million. Under the proposed rule, however, none of this

would have been possible; that's over $600 million in capital formation foregone. *See* Overdahl Report 7 ("The Commission should consider the possibility that the proposed rule change will impose a high cost on developmental-stage firms whose growth prospects would be completely stifled if the proposed rule change is finalized and implemented. By documenting these successful firms, the Commission would then be able to identify the success-story 'babies' that will in the future be tossed out along with the 'bath water' contained in the proposed rule change.").

Altogether, there can be no doubt that the proposed rule will impose a significant adverse effect on capital formation.

B. The Commission's Cost-Benefit Analysis Is Fundamentally Flawed.

In addition to the statutory requirements analyzed above, the Paperwork Reduction Act and Regulatory Flexibility Act require that the Commission undertake a thorough and accurate analysis of the costs that the proposed rules would impose on regulated entities and the economy as a whole. The APA, for its part, requires that this economic analysis be reasonable and substantiated, and that the conclusions that the Commission draws from the economic analysis have a reasoned, rational basis in the data the Commission gathers. Guidelines issued by the Commission further require that the data used in such regulatory analysis be "accurate, reliable and unbiased," that it be carefully reviewed by subject matter experts and appropriate levels of management,

and that there be "adequate disclosure about underlying data sources, quantitative methods of analysis and assumptions used, to facilitate reproducibility of the information, according to commonly accepted scientific, financial or statistical standards, by qualified third parties." U.S. Securities and Exchange Commission, Final Data Quality Assurance Guidelines (modified July 18, 2019), http://www.sec.gov/about/dataqualityguide.htm.

Here, however, the Commission concedes that it lacks the ability to reasonably estimate important components of the cost-benefit balance; entirely ignores other aspects of the problem, such as the sufficiency of existing protections; and provides estimates of the proposed rule's costs and burdens that are inadequate and far too low. The costs that the proposed rule will impose far outweigh any purported benefits identified by the Commission.

1. The Commission's Conceded Failure To Calculate Costs And Benefits Is Fatal.

The Commission's economic analysis is replete with frank admissions that it lacks the necessary data to estimate key components of the costs the proposed rule will impose. *See, e.g.*, 86 Fed. Reg. at 5072 ("due to data limitations, in many cases we are unable to" "quantify th[e] economic effects"); *id.* at 5074 ("[t]he net effect" on "existing shareholders is unclear"). As with the Commission's abdication of its duty to assess the effect of the proposed rule on efficiency, competition, and capital formation, this error is fatal.

The Commission has not considered, much less meaningfully attempted to assess the economic implications of, numerous costs of the proposed rule. For recipients of market-adjustable convertible notes, the Commission failed to estimate: (1) the number of firms that would go bankrupt by losing their "last resort" form of funding; (2) the higher costs of capital the surviving firms would pay for both (a) debt (due to higher-priced convertible loans) and (b) equity (due to less investor interest on account of higher risk, *see supra* p. 68); and (3) the foregone business opportunities. The Commission also failed to estimate numerous other costs, including: (4) investor losses associated with the impending bankruptcies; (5) employee hardships; (6) the value of products or services that will not come to market, such as a potentially lifesaving "new technology for screening for cervical cancer," Comment of Dr. Gene Cartwright, CEO, Guided Therapeutics (Feb. 4, 2021); and (7) the jobs that will not be created.

Moreover, the Commission has not even acknowledged the costs the proposed rule will impose on the firms that provide market-adjustable convertible loans. That is the entire business model of many firms. If the Commission is going to effectively shut many of them down—because there will no longer be an economical way to loan money to smaller public companies—the Commission must at least account for the massive disruption it is going to cause to those lenders and their employees. The SEC's failure to recognize, much less consider, these costs is especially inexcusable given that it encouraged these lenders to enter the convertible debt market in the first place. The fact that the SEC has now changed its mind about convertible lenders does not justify the

Commission's failure to account for them in its cost-benefit analysis, or acknowledge them at all, anywhere, in its proposal to undo years of prior SEC policy and rulemaking.

The Commission also lacks the data necessary to calculate the sole purported *benefit* of its proposed rule. The Commission claims that "[t]o the extent that [the proposal] would lead to fewer instances of significant, unregistered but public distributions of the underlying securities, it would enhance investor protection." 86 Fed. Reg. at 5074. "To the extent" is the give-away there. The Commission cannot estimate the benefit from its proposal because it has no idea whether there are any unregistered public distributions to begin with, and thus no clue whether the proposal will "lead to fewer" of them. *Id.* Moreover, the Commission does not—indeed, cannot—explain why the existing regulatory regime for Rule-144-compliant market-adjustable convertible securities does not provide a sufficient amount of disclosure and protection. *See supra* pp. 24–28. If there is no need for the proposed rule, there can be no benefits to outweigh the massive costs.

2. The Commission's Analysis Fails To Consider The Sufficiency Of Existing Protections.

Additionally, the Commission's "analysis is incomplete because it fails to determine whether, under the existing regime," "sufficient protections [already] exist[ ]." *Am. Equity*, 613 F.3d at 179. One of the most glaring absences in the proposal is the Commission's total silence on the fact that Rule 144 already conditions its use on the availability of "[a]dequate current public information" about the borrower. 17 C.F.R.

§ 230.144(c). Nor does the Commission have any comment on the fact that market-adjustable convertible notes are already disclosed to investors in a borrower's Form 8-K. *See supra* p. 15. The Commission, too, has nothing to say about the liability protections that exist under a number of other provisions—under both federal and state law—that provide more than enough protections for the market-adjustable convertible note market. *See supra* pp. 24–28. Likewise, the Commission does not address the fact that state corporate law generally already requires the boards of directors of public companies to approve the types of loans at issue here, *see, e.g.*, 8 Del. Code Ann. § 151(a), (e)—and that this same law tasks the board with a fiduciary duty to act in the best interests of the shareholders, *see, e.g.*, *Benihana*, 891 A.2d at 190–92. *See Am. Equity*, 613 F.3d at 178 (the Commission's analysis is inadequate because it failed to address the "baseline . . . under state law").

3. The Commission Vastly Underestimates Costs.

The estimated costs that the Commission does acknowledge are misleading and far too low. For example, the Commission states that the proposed rule "may also impose costs on some market participants including, but not limited to, an increase in the cost of financing and a decrease in total access to financing for unlisted issuers." 86 Fed. Reg. at 5074. That is, of course, true, but the Commission misleadingly undersells the point. "[S]ome market participants"? This rulemaking is *about* "unlisted issuers,"

the exact firms the Commission says will experience an "increase in the cost of financing and a decrease in total access to financing." *Id.* That is like proposing a rule for schoolchildren, while downplaying the costs because it will only harm "some people."

The Commission also acknowledges that the proposed rule "could affect existing shareholders . . . if [the rule] changes the propensity of . . . issuers to issue unregistered market-adjustable securities or if it changes the terms of those securities." 86 Fed. Reg. at 5074. Stated more clearly, that concession is fatal. By "changes the propensity" to "issue unregistered market-adjustable securities," *id.*, the Commission means that small unlisted companies will not be able to borrow money through the only source of capital they have available to them. When a "last resort" form of financing falls through, there is one outcome: bankruptcy. *Id.*

The Commission's claim that the impact of the proposed rule on "existing shareholders" is "unclear" is nonsense. 86 Fed. Reg. at 5074. Yes, conversions "may dilute the holdings of existing shareholders." *Id.* But again, the Commission admits that many of the firms using these loans would, without this valuable source of financing, be "approaching bankruptcy." *Id.* at 5072. There is no investor on Earth who would pick having his investment completely wiped out instead of facing some short term dilution.[16]

[16] The Commission claims that "[i]f" investors are "unaware of the existence of these contracts," they may be diluted without knowing it. 86 Fed. Reg. at 5074. But that is a

Finally, the Commission begrudgingly acknowledges that if the proposed rule deters lenders from making *market-adjustable* convertible loans, they will "demand a steeper upfront [fixed] discount." 86 Fed. Reg. at 5074. In other words, to the extent convertible loans will be available at all for smaller unlisted companies, the loans will result in *more* dilution, not less. *See id.* ("the proposed amendment may increase the potential dilutive effects of conversion"). Instead of linking the conversion discount to the actual market price at the time of conversion, lenders will need a fixed discount to the market price at the time of the loan that is sufficiently large to cover bankruptcy risk, as well as any subsequent drop in market price—and because the bigger the discount, the more shares that must be issued to the lender, this would result in massive dilution in *every* deal. Far from fixing the asserted problem, the Commission's proposal will exacerbate it.

C. The Commission Has Not Given The Public A Meaningful Ability To Participate In This Rulemaking.

The Commission admits that it has performed no data analysis to support the proposed rule. Instead, the Commission has asked "commenters to submit data or studies that would facilitate estimating [the] effects" of the proposal. 86 Fed. Reg. at 5074. But, at the same time, the Commission has steadfastly refused to release the very

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big, unsupported "If." *If* there is any evidence that investors are *not* aware of these publicly disclosed deals, the Commission has not cited it.

data that would permit commenters to perform the studies the Commission has requested. This refusal is confounding—and unlawful.

The Commission posted the proposed rule to its website before the proposal was published in the *Federal Register*. Within days, counsel for SPCC requested the data underlying the Commission's limited analysis of the relevant economic baseline. *See* Letter from Helgi C. Walker, Partner & Barry Goldsmith, Partner, Gibson, Dunn & Crutcher LLP, to John Fieldsend & Sean Harrison, Office of Rulemaking, Div. of Corp. Fin., SEC (Jan. 8, 2021), *available at* https://www.sec.gov/comments/s7-24-20/s72420-8221273-227702.pdf. In addition to contacting the officials in the Office of Rulemaking identified in the proposal, *see* 86 Fed. Reg. at 5064, counsel for SPCC copied the Acting Director of the Division of Corporation Finance and the public comment file in this matter. They explained that in the proposal the Commission had identified 106 issuers who, in 2019, had received market-adjustable convertible loans in 207 deals. *See id.* at 5073. Because that data would facilitate the very studies the Commission had requested, and because the public is legally entitled to the "data that [the Commission] has employed in reaching the decisions to propose particular rules," *Solite Corp. v. EPA*, 952 F.2d 473, 484 (D.C. Cir. 1991) (internal quotation marks omitted), counsel for SPCC requested that the Commission post the data to the public comment file. The Commission never responded.[17]

[17] Separately, counsel for SPCC submitted a Freedom of Information Act request for (among other things) any "analyses, reports, and other information" the Commission

That failure alone is fatal to this rulemaking. The Commission has failed to perform any meaningful analysis of the proposed rule, and instead has asked the *public* to conduct the studies for it. But it is the agency's job to support its proposal. Nevertheless, the Commission has refused to produce the very data that members of the public have expressly requested—months in advance—to facilitate conducting the analyses the Commission itself has failed to do. The APA does not permit this, and no court would accept it. The Commission should abandon this misguided proposal.

CONCLUSION

The Commission should not proceed with the proposed rule, which will only harm small public companies and their investors. The Commission instead should support our nation's smallest public companies as they seek the capital they need to grow into the American success stories of tomorrow.

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had assembled about the impact on convertible note lending of related enforcement actions the Commission has launched. Letter from Helgi C. Walker, Partner, Gibson, Dunn & Crutcher LLP, to Office of FOIA Services, SEC 1 (Sept. 22, 2020) (Exhibit E). Again, despite a legal requirement to respond to that request, *see* 5 U.S.C. § 552(a)(6)(A)(i); 17 C.F.R. § 200.80(d)(2), the Commission has not done so.

March 22, 2021

Respectfully submitted,

/s/ Helgi C. Walker

Helgi C. Walker
Brian A. Richman
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Avenue, N.W.
Washington, DC 20036-5306
(202) 955-8500
hwalker@gibsondunn.com

Barry Goldsmith
M. Jonathan Seibald
GIBSON, DUNN & CRUTCHER LLP
200 Park Avenue
New York, NY 10166-0193
(212) 351-2440
bgoldsmith@gibsondunn.com

Attorneys for
Small Public Company Coalition

Exhibit A

March 20, 2021

Mr. Barry Goldsmith, Esq.
Gibson, Dunn & Crutcher LLP
200 Park Avenue, New York, NY 10166

Dear Mr. Goldsmith,

You have asked me to provide my views on the likely economic impact of the SEC's proposed amendment to Rule 144(d)(3)(ii) that would eliminate "tacking" for securities acquired upon the conversion or exchange of the market-adjustable securities of an issuer that does not have a class of securities listed, or approved to be listed, on a national securities exchange. In particular, you have asked that I opine on the analysis of the likely economic impact of the proposed amendment as contained in the Commission's Federal Register release dated January 19, 2021 and to address the questions posed for public comment by the Commission in that release regarding economic impact.[1]

I have formed my views based on the SEC's protocol for conducting economic analysis in rulemaking and my own experience in assessing the economic impact of Federal rules over the past 30 years, including my experience as the SEC's Chief Economist from 2007-2010. In my role as Chief Economist, I directed the Commission's process for assessing the likely economic

[1] Release Nos. 33-10911; 34-90773; File No. S7-24-20 – Rule 144 Holding Period and Form 144 Filings

impact of proposed rules and rule changes. My experience is detailed in my CV which I have attached to this report. I have also based my views on information I have gathered from discussions with industry practitioners.

Among other things, the proposed amendment changes the holding period determination for the class of securities described above so that the holding period for convertible securities would not begin until the date of the conversion or exchange into shares of the issuing company. A holding period is one criterion established to demonstrate that the selling security holder did not acquire the securities to be sold under Rule 144 with distributive intent. The Commission argues that this proposed change to the holding period determination will mitigate the risk of unregistered distributions in connection with sales of market-adjustable securities.

The proposed amendment would reverse the position the Commission adopted in 2007 when it most recently determined that the application of the ''tacking'' provisions to at-risk market-adjustable securities provided for an appropriate period of time prior to resale to demonstrate that the seller did not purchase the securities with a view to distribution and, therefore, was not an underwriter for the purpose of Securities Act Section 4(a)(1). After considering 42 public comments, the 2007 Commission failed to find that the tacking provision for restricted securities, which has existed in some form since 1972, would "undermine" the intent of Rule 144.

As the Commission acknowledges, the economic analysis contained in the proposal release is preliminary. In order to gain a more complete understanding of the likely economic impact of the proposed rule, the Commission has invited public comment to a set of questions. Included in these questions is an open-ended invitation for commenters to advise the Commission as to whether it has assessed all the costs and benefits to market participants who would be affected by the change in the tacking provision.

The primary purpose for conducting a rigorous assessment of the likely economic impact of any proposed rule change is to promote transparency and accountability in regulatory decisions. It is only after careful consideration of the economic impact that the Commission can determine whether there is a reasonable basis for exercising its rulemaking authority. To justify its exercise of rulemaking authority, the SEC has a duty under the Administrative Procedure Act (APA), as applied to the SEC's governing statutes, to adequately consider whether a regulatory action "will promote efficiency, competition and capital formation."[2]

With respect to the economic analysis contained in the proposing release I find that:

- The Commission's assessment of the likely economic impact of the proposed rule change is incomplete and fails to include rigorous analysis of significant questions the Commission needs to consider before concluding that there is a reasonable basis for the proposed rule change.
- The Commission needs to assess the impact of the 2007 rule changes because they are a mirror image guide to assessing the likely economic impact of the current proposed rule change. Given that the 2007 rule change has been in effect for more than 13 years, there is a wealth of readily available data from which the Commission can assess the likely economic impact of the proposed rule change. This is because the proposed rule change largely reverses the 2007 rule change for unlisted issuers.
- The Commission should document, with data available to the Commission, some of the impacts that are currently discussed as theoretical possibilities. The Commission should also make available to the public data it gathers that can help address the issues in the proposed

[2] 15 U.S.C. §§ 78c(f), 77b(b).

amendment. Making the SEC's dataset publicly available would help facilitate the public comment process.

- The Commission should attempt to validate the anecdotal observations offered by practitioners in the public comment file.
- The Commission should consider reasonable alternatives that may achieve the Commission's objectives without negatively impacting efficiency, competition, or capital formation.

In response to the Commission's request for comment I address the following questions from the release:

[Question #30 from the proposing release]. What are the economic effects of the proposed amendments to Rule 144(d)(3)(ii)?

A starting point in any assessment of the likely economic impact of regulatory actions is to properly frame the analysis by clearly articulating the purpose of the proposed rule change. The Commission claims that this proposed change to the holding period determination is narrowly constructed for the purpose of mitigating the risk of unregistered distributions in connection with sales of market-adjustable securities. However, a review of the public comment file suggests a broader perceived purpose to the proposed rule change such as curbing "microcap fraud" "bad actors" "toxic convertibles" "abusive practices" "out of control dilution" and "death spiral financing." The Commission's economic analysis refers to investor protection as one product of the proposed rule change. If it is true that the rule change is aimed at a broad array of perceived undesirable conduct that harms investors, then the Commission should explicitly say so and state the purpose in a way that is transparent and promotes accountability in the exercise of their rulemaking authority. If the purpose of the rule is to curb certain supposed undesirable conduct, the Commission should document the prevalence of this conduct, such as through investor and

customer complaints to the Commission. If conduct like death spiral financing is a problem the Commission is seeking to curb, then instances should be documented to show that it is a material concern and not just a theoretical possibility.[3]

As the Commission acknowledges, the main economic characteristic of market-adjustable securities is that they may provide protection to the holder against declines in market value from the time of purchase of the overlying security until the time of conversion or exchange. A market-adjustable feature with a discount to a variable conversion price that helps the debt holder preserve the value of the conversion option. For example, the holder of the convertible debt may have the right to convert to a specified number of shares at a conversion price that is a percentage (e.g., 70 percent) of the prevailing market price for the shares at the conversion date. The market price may be determined by an agreed-upon formula, e.g., the low price observed in the 15 trading sessions prior to the conversion date. The market-adjustment feature serves as a risk-management tool for the debt holder that preserves the value of the conversion option so that it is invariant to the future price of the underlying shares.

The market-adjustment risk management feature operates in a similar way to hedges constructed with continually adjusted short positions (and sometimes listed option positions) for conversions done at fixed conversion prices for listed securities. These hedges are constructed to lock in the value of the conversion option so that it is "delta neutral," that is, invariant to the future price of the underlying shares. The difference in hedge constructions emerge in the post-conversion holding period where short selling and listed option contracts are available to hedge the risk

[3] It seems that convertible lending could prevent at least one type of undesirable conduct: pump and dump schemes. The more convertible debt a company has, the more difficult it will be to pump the stock because the lender could always convert and sell as the price rises, keeping the price in proper alignment with its fundamental value. The proposed rule change, by eliminating the tacking period, will significantly reduce lending through market-adjustable convertible loans to unlisted issuers, which in turn would likely reduce this beneficial effect.

associated with listed shares but where no risk-management tools are available to construct hedges for unlisted shares beyond the market adjustment realized at conversion. I fail to see why one risk management feature is viewed by the Commission as a failure to assume economic risk while other risk management features are not viewed that way, even though these different risk management features are used for economically equivalent purposes, that is, for preserving the value of the conversion option pre-conversion.[4]

The most likely impact of the proposed rule change is on capital formation for public companies similarly situated to those companies currently using this form of convertible debt financing, that is, development-stage public companies with limited capital and revenue. I address the economic impact of the proposed rule change on capital formation more fully below in response to Question #32.

The Commission should comprehensively document the importance of this type of financing to firms, and determine what, if any, alternative sources of financing would be available to these firms if convertible market-adjusted financing was no longer available to them due to the implementation of this proposed rule change. If this type of financing disappeared as a result of the costs imposed by the proposed rule change, how many firms may go bankrupt due to lack of viable financing options, and what would be the related impact of bankruptcy caused by the lack of available financing options? For conducting this analysis of economic impact, a reasonable answer to this question would start by assuming the bankruptcy of all firms with non-listed stock currently using adjustable-market convertibles. The Commission should also consider the

[4] The Commission's discussion of economic impact includes a discussion of arbitrage hedge fund activity and arbitrage-related activity that complicates an analysis of interpreting the value of convertible bond financing. However, since the shares at issue in the proposed rule change are unlisted, these concerns should be ignored as this type of arbitrage with unlisted securities is not possible.

related impact of bankruptcy on jobs lost, including job growth foregone for the subset of companies that in the future would have become successful listed companies.[5]

The Commission should also document instances of companies that used this type of convertible financing to obtain the capital they needed to grow into successful listed companies. The comment file provides evidence of the importance of this form of financing to particular firms, including firms that eventually became large, listed companies. These companies relied on this financing in their developmental stage. As the Commission's review of the financial economics literature shows, these issuers have limited options to raise capital and issue market-adjustable securities as a ''last resort'' form of financing. The Commission should consider the possibility that the proposed rule change will impose a high cost on developmental-stage firms whose growth prospects would be completely stifled if the proposed rule change is finalized and implemented. By documenting these successful firms, the Commission would then be able to identify the success-story "babies" that will in the future be tossed out along with the "bath water" contained in the proposed rule change.

In its effort to understand the likely economic impact of the proposed rule change, the most obvious place to look for evidence would be from the period surrounding the 2007 rule change that codified tacking and effectively shortened the holding period for market adjustable convertible securities. Since the currently proposed rule change would effectively reverse for unlisted issuers the position the Commission took at that time, assessing the impact of the 2007 rule change becomes a mirror image guide to assessing the likely economic impact of the currently proposed rule change. The comparison is not precisely "apples to apples," due to the

[5] The comment file includes letters from firms that relied on market-adjustable convertible financing during their developmental stage. In addition to these examples, the following link contains a further example (fuboTV) https://www.reuters.com/article/fubotv-ipo-idUSKBN26T0BZ .

fact that some form of tacking existed prior to the 2007 rule change. However, the 2007 rule change effectively shortened the holding period for securities acquired upon the conversion or exchange of the market-adjustable securities of an issuer that does not have a class of securities listed, or approved to be listed, on a national securities exchange. The currently proposed rule change would effectively lengthen the holding period for these securities, the opposite of what the 2007 Commission did in its rule change.

By looking to the data and evidence from the 2007 experience over a sufficiently long event window, the Commission could gauge the likely impact of the proposed rule change. The event window needs to be long enough to extend beyond the financial crisis of 2008. The Commission could answer the question of whether shortening the holding period in 2007 led to more convertible financing and promoted capital formation. Anecdotal evidence from practitioners suggests that the 2007 rule change was a significant factor in expanding the market for market-adjustable convertible lending, but the impact was not felt until after 2009 because of the financial crisis. Moreover, for reporting companies that publicly disclosed their convertible contracts, the Commission could see if the terms of these contracts changed in meaningful ways. For example, the Commission could determine if the discount adjustment at conversion was impacted by the effective shortening of the holding period. Information on the 2007 experience should be available in S.E.C. filings or in data collected by commercial vendors such as Mergent.

The 2007 Commission stated that "We do not want the holding period to be longer than necessary or impose any unnecessary costs or restrictions on capital formation." After observing the operation of Rule 144 since the 1997 amendments, the 2007 Commission determined that the shorter effective holding period for securities of reporting issuers provided a reasonable indication that an investor had assumed the economic risk of investment in the securities to be

resold under Rule 144. I am not aware of any new evidence developed since 2007 that is capable of refuting the view of the 2007 Commission.

The Commission should also consider the potential impact of the proposed rule change on transparency with respect to the financial condition of the companies using convertible debt. I understand that many companies file their 8-Ks and 10-Qs to be able to use convertible loans. If market-adjustable convertible debt for unlisted companies is curtailed as a result of the proposed rule change, fewer companies will be filing 8-K and 10-Q disclosures, which seems inconsistent with the Commission's longstanding desire for having more disclosure available to the investing public. As been recognized throughout the Commission's history, "[t]he SEC is first and foremost a disclosure agency."[6]

I understand that some unlisted companies use the proceeds from market-adjustable convertible loans to pay their auditors. A company with no revenue and no other sources of financing will need convertible loans to fund its operations and prepare the audited financial statements. This is another factor related to the transparency of the financial condition of issuing companies that the Commission should consider when evaluating its proposed rule change.

[Question #30 from the proposing release--continued]. To the extent possible, please provide any data, studies, or other evidence that would allow us to quantify or better qualitatively assess the costs and benefits of the proposed amendments to affected parties.
I am unable to provide data myself, but I see in the Commission's economic analysis a number of questions that require the application of data and evidence to answer. I also see key assumptions in the narrative that should be validated with data and evidence.

[6] See 2013 remarks of then Commissioner Dan Gallagher found at https://corpgov.law.harvard.edu/2013/07/16/the-importance-of-the-sec-disclosure-regime/ or the 2003 remarks of then Commissioner Paul Atkins describing the SEC as "a disclosure-based agency." See Paul. S. Atkins, Comm'r, U.S. SEC, Recent Experience with Corporate Governance in the USA (June 26, 2003), available at 2003 WL 21515877.

For example, the Commission should seek information about who the investors are in the shares of the firms using market-adjustable convertible securities with underlying unlisted securities. Are the investors company officers and Board members? Is any retirement money of pension funds being invested in these shares? Are retail investors committing small sums to investments they know are risky but may pay off if the venture is successful? The answer to this inquiry would help address whether or not this activity poses any investor protection issues.

The Commission should comprehensively document the importance of this type of financing to firms, and determine what, if any, alternative sources of financing would be available to these firms if convertible market-adjusted financing was no longer available to them due to the implementation of this proposed rule change. What would the cost be for issuers forced to seek alternative sources of financing?

The Commission should also seek to answer questions about the economic risk assumed by holders of convertible debt prior to conversion. How many firms with unlisted shares, who are using market-adjustable convertible debt, go bankrupt before conversion? How many issuers pay off their debt prior to conversion?

The Commission should also seek to answer questions about the characteristics of firms using convertible debt. How many firms with unlisted stock repeatedly use market-adjustable convertible debt? Documenting the share of repeat business would be an indicator of the value that firms place on this form of financing. The Commission should document instances of companies that used this type of convertible financing to form the capital they needed to grow into successful listed companies. Which firms with unlisted shares use market-adjustable convertible debt?

The Commission should also seek to answer questions related to the resale of shares acquired through conversion. How are shares acquired through conversion resold? How long is the typical liquidation period? How many shares are sold at one time? How many shares are sold each day? How often do DTCC capital requirements constrain brokers attempting to resell unlisted shares acquired from market-adjustable convertible debt?

The Commission should also seek to answer questions about how the proceeds of resold shares are used. Understanding what happens to the proceeds may be important to assessing the impact of the proposed rule on capital formation. How are the proceeds accrued from the resale of shares acquired through convertible debt used? Can the claim made by practitioners, that a large share of these proceeds are used to originate new lending, be validated?

If the purpose of the rule is to curb certain perceived undesirable conduct, the Commission should document the prevalence of this conduct, such as through investor and customer complaints to the Commission. If conduct like death spiral financing is a problem the Commission is seeking to curb, then instances should be documented to show that it is a material concern and not just a theoretical possibility.

The Commission should document the flexibility and speed of this type of financing and consider these factors in their analysis of the economic impact of the proposed rule change. If the proposed rule change significantly curtails or eliminates this form of convertible financing, this flexibility and speed would be lost to market participants as well. This loss of flexibility and speed would be one potential cost of the proposed rule change as the range of financing options is constrained.

Data collected and filtered by Mergent may be helpful to the Commission in looking at convertible securities across time. Such data may be useful in understanding the impact resulting from the 2007 rule changes, which should allow inferences about the likely impact expected if the proposed rule changes are adopted and implemented. This set of data may also provide information about the impact of the 2007 rule change on the terms of contracts involving market-adjustable convertible debt.

[Question #30 from the proposing release--continued]. Have we assessed all of the costs and benefits to market participants who would be affected by the change in tacking provisions?
No.

The Commission argues that the resale of unlisted shared acquired through market-adjustable convertible debt is without risk. This assertion is also made in the cost-benefit discussion in the economic analysis contained in the release. The Commission states that "Permitting the holding period of the underlying securities to be 'tacked' onto the holding period of the convertible or exchangeable security allows the initial holders of market adjustable securities to structure transactions without significant economic risk prior to conversion." This is not true. The pre-conversion period of holding the convertible debt is also risky for the note holder. There are risk factors the Commission should consider in their analysis. For example, a sizable number of firms go bankrupt before conversion and are therefore unable to pay off their debt either through cash or stock. Risk also arises in the resale of shares acquired through conversion due to constraints imposed by brokers who face capital requirements with the DTCC. Brokers may limit the number of high-risk, volatile, shares that can be sold on any given day to avoid having to post additional capital with the DTCC. In other words, if brokers cannot meet DTCC capital requirements, the shares acquired through conversion may need to be held and exposed to market risk. In addition, there is no way for debt holders to manage the risk associated with these

convertible shares through hedges constructed with short positions (or possibly listed options positions) as the companies targeted by the proposed rule change are not listed companies. The SEC should document the outcomes of convertible market-adjusted lending so that they can carefully consider the risk exposure of lenders prior to conversion.

In addition, liquidity constraints prevent the holder of unlisted shares acquired through conversion from selling these shares quickly. The stocks acquired through conversion are by their nature illiquid as the Commission acknowledges. Lenders are exposed to liquidity risk as they attempt to sell unlisted shares acquired through conversion. Because of liquidity risk, shares may be sold in small increments across time. This means that shares are not immediately sold but are held across a liquidation period. The Commission could look at shares acquired through conversion to document what a typical liquidation period is and what the risk associated with that liquidation period would be. The Commission should also conduct an analysis of the process by which unlisted shares acquired through conversion are resold to see if what happens in practice conforms to the theoretical possibility of instant resale that is assumed in the economic analysis of the proposing release. For the microcap market, the size of the discount may in part be explained by the length of the liquidation period.

As the Commission acknowledges, the proposed amendment would expose the holder of the market-adjustable debt to the economic risk of the underlying securities during the proposed corresponding holding period following the conversion or exchange. Exposing these investments to this additional risk during the post-conversion or post-exchange period would limit market-adjustable security holders' ability to quickly resell converted or exchanged market-adjustable securities. However, as the Commission acknowledges, the potential impact of the proposed rule change is to reduce the liquidity of these investments, and thus could prevent some unlisted

issuers from obtaining financing or increase the costs of doing so, particularly since market-adjustable securities may constitute a ‘‘last resort’’ form of financing for issuers.

The 2007 Commission found that shortening the holding period would increase the liquidity of privately sold securities and decrease the cost of capital for reporting issuers. The 2007 Commission expected that an increase in liquidity would help companies to raise capital more easily and less expensively.

As the 2007 Commission observed, convertible lending has attributes of flexibility and speed that are not associated with other types of lending. I understand anecdotally that this type of financing can be arranged and finalized within 24 hours of application because of the fact that this form of lending relies on publicly available information about the issuers. This means that the magnitude of the risks to lenders can be quickly and confidently understood. As discussed above, the Commission should document the flexibility and speed of this type of financing and consider these factors in their analysis of the economic impact of the proposed rule change. If the proposed rule change significantly curtails or eliminates this form of convertible financing, this flexibility and speed would be lost to market participants as well. This loss of flexibility and speed would be one potential cost of the proposed rule change as the range of financing options is constrained.

The Commission has also expressed concern about the dilutive effects of convertible financing and the impact on existing shareholders. First, it would seem that this concern would extend to any convertible financing and not just market-adjustable conversions. Second, the shareholders of the borrowing firms are often the firm’s senior officers and the loans are done with explicit Board approval. Senior officers and Board members often own large blocks of controlling shares, something the Commission could document. The Commission needs to explain in their

analysis why they expect that senior officers and Board members would act against their own interests by approving these deals. The SEC should document who owns the shares of the companies using this type of financing to validate or reject the anecdotal observations that senior officers and Board members hold large blocks of unlisted shares in companies using market-adjustable convertible loans. Also, the existence of convertible loans is reported in 8-K filings so any investor concerned about dilution could have time to exit their position prior to conversion.[7] In evaluating whether market-adjustable convertible lending negatively impacts current shareholders, the Commission should consider instances where lenders do repeat business with the same borrowing firms needing financing. If these shareholders were truly being disadvantaged, the Commission needs to explain these instances of repeat business. The number of instances of repeat business could be documented by the Commission to validate or reject the anecdotal evidence.[8]

The economic analysis contained in the proposing release provides a comprehensive review of the financial economics literature as applied to convertible financing and the economic issues this type of financing addresses. But none of the citations are directly related to the type of convertible loans at issue in the proposed rule change.

[7] From the perspective of the lender, the level of dilution is tied to the risk faced by the lender. From the perspective of the issuer, they are opting to pay back their loans through conversion because they value the cash proceeds from the loan more than the resulting dilution. In a "last resort" situation, issuers are willing to trade off dilution in exchange for not going bankrupt. In a competitive market, market forces will determine the level of dilution. The Commission should consider why borrowers and lenders agree to convertible lending terms resulting in dilution before concluding that dilution necessarily is excessive or that it impacts current shareholders in a negative way.

[8] This argument is supported by one commentor who observed that convertible market-adjustable loans are typically publicly disclosed at the time the loans are made, so existing and potential shareholders are fully aware of the loans many months before there is any potential conversion. That gives potential shareholders the opportunity to decline to invest in companies that have received these loans, and existing shareholders the opportunity to sell their shares well before any potential conversion. The commenter also observed that it would make no sense for officers and directors to approve taking out convertible loans that harm the long-term value of their own shares as well as those of other shareholders.

There are reasonable alternatives that the Commission should analyze and consider. For example, if the Commission's rule change eliminating tacking for market-adjustable securities applied only to non-reporting companies, it would have the effect of minimizing the risk to the public of unregistered distribution of securities obtained through market-adjustable securities without unnecessarily suppressing the ability of microcap companies to obtain capital.

Another alternative the Commission could consider is amending their disclosure regulations to make it mandatory for companies to file 8-K disclosures if they receive convertible financing. In addition, mandatory disclosure through 8-K disclosures of the terms of the convertible financing could be required by the Commission. If not already required by corporate law, the Commission could require mandatory Board approval of the terms of convertible debt. Finally, the Commission could devote more enforcement resources towards rooting out cases of fraud or other undesirable conduct using their existing authority.

[Question #31 from the proposing release]. Please provide any data, studies, or other evidence that would allow us to quantify this component of the industry baseline.

The Commission's baseline for conducting its economic analysis of the proposed amendment should be extended much further back (beyond 2019) to capture changes to this market resulting from the 2007 rule changes that effectively shortened the holding period for restricted securities.

[Question #32 from the proposing release]. What is the impact of the proposed rule on efficiency, competition, and capital formation?

As the SEC itself recognizes in its proposed rulemaking, "the proposed amendment is likely to have an effect on capital formation" and "could prevent some unlisted issuers from obtaining

financing or increasing the costs of doing so, particularly since market-adjustable securities may constitute a 'last resort' form of financing for issuers."[9]

As discussed previously, the most likely impact of the proposed rule change is on capital formation for companies similarly situated to those companies currently using this form of convertible debt financing, that is, development-stage companies with limited capital and revenue. The economic analysis contained in the proposing release describes these firms as being concentrated in the pharmaceutical, biotechnology, and business technology industries. As the Commission recognizes, one likely result of the proposed rule change is that discounts at conversion will need to be much higher to account for the additional holding-period risk borne by the lender. If the proposed rule change is implemented, it is not clear that there will be a discount level that is viable for both lenders and borrowers. Investors who are restricted from selling securities and who cannot hedge their positions are generally exposed to more risk than those who are not subject to such limitations, and generally require higher compensation (or a larger discount with respect to the securities) for this risk.[10] The end result may be the elimination or substantial curtailment of this type of financing. The economic analysis contained in the proposing release acknowledges this potential outcome by stating "We expect that this proposed amendment would discourage parties from engaging in such transactions."

In its effort to understand the likely economic impact of the proposed rule change on efficiency, competition, and capital formation, the most obvious place to look for evidence would be from

[9] *Federal Register*, Vol. 86, No. 11, January 19, 2021, page 5073.

[10] The size of the discount is the result of negotiation between the borrower and the lender. The longer the required holding period post-conversion, the larger the discount that will be required by lenders to account for the risk of holding often-volatile shares over a longer holding period. To the extent the Commission is concerned about the level of discounts required by lenders as an investor protection matter, consideration should be given to the likelihood that discounts required by lenders would be even larger if the proposed rule change is adopted and a longer required holding period results.

the period surrounding the 2007 rule change that codified tacking and effectively shortened the holding period for market adjustable convertible securities. The 2007 Commission stated that their intent in shortening the holding period for market-adjustable convertible loans was to help companies to raise capital more easily and less expensively. Since the currently proposed rule change would effectively reverse for unlisted issuers the position the Commission took in 2007, assessing the impact of the 2007 rule change becomes a mirror image guide to assessing the likely economic impact of the currently proposed rule change. I have discussed in detail in response to Question #30 how data from the 2007 experience could be applied to assessing the economic impact of the currently proposed rule change.

Currently, convertible lenders are able to resell shares acquired upon conversion at the conversion date. The Commission should consider what lenders do with the cash they raise form these sales. I understand anecdotally that a substantial share of these funds are used to originate new loans, often as additional tranches of lending to the same firm. The Commission should seek to document what happens to the cash raised from the resale of shares acquired through market-adjusted conversions. A longer holding period may impede the flow of convertible financing to potential borrowers and curtail capital formation as a result. If it can be verified that cash raised through the sale of shares acquired through conversion is used to facilitate further capital formation, the Commission should consider this factor in their analysis of the economic impact of the proposed rule change.

A shorter holding period requirement for restricted securities may result in increased efficiency in securities offerings to the extent that companies are able to sell securities in private offerings at prices closer to prices that they may obtain in public markets, without the need to register those securities, and otherwise obtain better terms in private offerings. As discussed previously, a

shorter holding period is likely to promote greater liquidity in shares upon conversion. This increase in liquidity in turn helps promote capital formation, particularly for smaller companies. Therefore, a shorter holding period should increase a company's ability to raise capital in private securities transactions, which may improve the competitiveness of those companies, particularly smaller businesses that do not have ready access to public markets.

Conclusion.

As the Commission acknowledges, the economic analysis contained in the proposal is preliminary. The Commission's current assessment of the likely economic impact of the proposed rule change is incomplete and fails to include rigorous analysis of significant questions the Commission needs to consider before concluding that there is a reasonable basis for the proposed rule change. As a threshold matter, the Commission has failed to provide any evidence that the 2007 rule change, which codified the tacking provision for restricted securities, in any way undermined the intent of Rule 144. The Commission needs to assess the impact of the 2007 rule changes because they are a mirror image guide to assessing the likely economic impact of the current proposed rule change. This is because the proposed rule change largely reverses the 2007 rule change for unlisted issuers. The Commission should document, with data available to the Commission, some of the impacts that are currently discussed as theoretical possibilities. The Commission should also attempt to validate the anecdotal observations offered by practitioners in the public comment file.

To the extent that this proposed rule change is aimed at perceived undesirable market conduct, the proposed rule change should be directed at that conduct and should not be used as a blunt instrument that captures both beneficial activity and undesirable conduct. If it is true that the rule change is aimed at a broad array of undesirable conduct that the Commission believes harms

investors, then the Commission should explicitly say so and state the purpose in a way that is transparent and promotes accountability in the exercise of their rulemaking authority.

Respectfully submitted,

James A. Overdahl, Partner
Delta Strategy Group
600 Pennsylvania Avenue SE, Suite 300
Washington, DC 20003
DATED: March 20, 2021

DeltaStrategy Group
600 Pennsylvania Avenue SE Suite 300 Washington, DC 20003 T 202.547.3035

JAMES A. OVERDAHL, PH.D.
PARTNER

Dr. Overdahl is a specialist in financial markets and the U.S. regulatory environment. Prior to joining Delta Strategy Group as a partner in August 2013, Dr. Overdahl provided advisory and expert witness services through NERA Economic Consulting. Dr. Overdahl's financial regulatory experience includes three years as Chief Economist for the US Securities and Exchange Commission (SEC) and five years as Chief Economist for the US Commodity Futures Trading Commission (CFTC). He is experienced in preparing expert reports and in serving as a testifying expert in matters involving complex financial litigation. In his positions at the SEC and CFTC, Dr. Overdahl testified before each Commission. He also testified before Congress on behalf of the SEC and CFTC, and provided staff support and briefings for members of the President's Working Group on Financial Markets.

While serving as Chief Economist of the SEC from 2007 to 2010, Dr. Overdahl directed the SEC's Office of Economic Analysis where he served as principal economic advisor on policy, rulemaking, and litigation support and supervised the SEC's economics program. He advised the Commission on a wide range of policy matters, including, credit default swaps and other OTC derivatives, OTC clearing, algorithmic trading and related market structure issues, securities lending, short selling, and new products. In addition, he advised the Commission and other government agencies on several matters related to the financial crisis of 2008. He also advised the Commission on investigation matters, enforcement proceedings, civil monetary penalties, disgorgement, and fair-fund distribution plans.

While serving as Chief Economist of the CFTC from 2002 to 2007, Dr. Overdahl directed the CFTC's Office of the Chief Economist. He advised the Commission on policy matters related to exchange-traded futures and options, OTC derivatives (particularly energy derivatives), commodity price speculation, risk management and hedging, new products and markets, algorithmic trading, position limits, clearing, commodity index investing, hedge funds, and error trade policies. He also advised the Commission on enforcement matters related to commodity price manipulation and the alleged false reporting of natural gas transactions by several entities. In addition, he advised the Commission on restitution and civil monetary penalties.

Dr. Overdahl has also served as a Senior Financial Economist for the Risk Analysis Division of the US Office of the Comptroller of the Currency (OCC). He performed on-site assessments of risk measurement models, including Monte Carlo simulation models, historical simulation models, variance-covariance models and stress testing models, employed by Tier 1 dealer banks, and assessments of model validation procedures within the risk management units of money center banks, of compliance with the Value-at-Risk requirements of the Basel Market Risk Capital Rule, and of the effectiveness of hedging and risk measurement techniques used to manage market risk in securitization conduits.

Prior to joining the OCC, Dr. Overdahl served as a Financial Economist in the CFTC's Division of Economic Analysis and the SEC's Office of Economic Analysis. He has taught as an Adjunct Professor of Finance at George Washington University, the University of Maryland, Johns Hopkins University, Georgetown University, Virginia Tech, and George Mason University. Dr. Overdahl also served as Assistant Professor of Finance at the University of Texas at Dallas School of Management.

Dr. Overdahl has published extensively in leading economics and finance journals, including the *Journal of Business, Journal of Law and Economics, Journal of Financial and Quantitative Analysis*, *Journal of Futures Markets*, *Journal of Derivatives,* and *Journal of Alternative Investments,* and has contributed numerous chapters to published volumes on finance and economics. In addition, he has co-edited and co-authored, with Robert Kolb, four books in multiple editions including *Financial Derivatives: Pricing and Risk Management* and *Futures, Options, and Swaps*.

EDUCATION

Ph.D., Economics, Iowa State University, Ames, IA, 1984.

B.A., Economics, St. Olaf College, Northfield, MN, 1980.

CURRENT POSITION

Partner, Delta Strategy Group, Washington, DC, August 2013–Present.

PRIOR POSITION

Vice President, Securities and Finance Practice, National Economic Research Associates, Inc., April 2010 – August 2013, and Affiliated Industry Expert, August 2013–Present.

GOVERNMENT POSITIONS

Chief Economist and Director of the Office of Economic Analysis, U.S. Securities and Exchange Commission, Washington, D.C. 2007-2010.

Served as principal economic advisor on policy, rulemaking, and litigation support. Supervised the economics program with a professional staff of approximately 40 Ph.D. economists, analysts, and consultants. Testified before the Commission and before Congress on behalf of the Commission. Provided staff support for President's Working Group on Financial Markets and for other interagency groups related to financial market reform and market developments.

Chief Economist and Director of the Office of the Chief Economist, U.S. Commodity Futures Trading Commission, Washington, D.C. 2002-2007.

Director of the CFTC's Office of the Chief Economist. Supervised the CFTC's economics program utilizing a staff of professional economists and support personnel performing economic research, policy analysis, expert testimony, education, and outreach (including congressional briefings). Served on the Commission's Executive Management Council. Testified before the Commission and before Congress on behalf of Commission. Provided staff support and briefings for members of the President's Working Group on Financial Markets on issues related to derivative markets and hedge funds.

Senior Financial Economist, Risk Analysis Division, Office of the Comptroller of the Currency, Washington D.C. 1995-2002.

Performed assessments of risk measurement models, valuation models, model validation procedures, and compliance with the Value-at-Risk requirements of the Basel Market Risk Capital Rule.

Senior Financial Economist, Research Section, Division of Economic Analysis, Commodity Futures Trading Commission, Washington D.C. 1992-1995.

Conducted empirical research on policy issues before the Commission relating to exchange-traded and privately-negotiated derivative instruments. Assisted the CFTC's Division of Enforcement both in developing economic evidence and in devising civil monetary penalties for use in CFTC enforcement proceedings. Assisted the Commission's Administrative Law Judges in devising sanctions.

Senior Financial Economist, Office of Economic Analysis, U.S. Securities and Exchange Commission, Washington D.C. 1989-1992.

Served as in-house economic consultant to the SEC's Division of Market Regulation on issues involving derivative instruments and capital markets. Assisted the SEC's Division of Enforcement in the development of economic evidence for use in civil cases brought before the Commission. Assisted U.S. Attorney's Office in developing evidence for criminal cases resulting from SEC referrals to the Justice Department.

ACADEMIC POSITIONS

Adjunct Professor, University of Maryland, 2003-2007.

Adjunct Professor, George Washington University, 2002-2007.

Adjunct Professor, Johns Hopkins University, 2001.

Adjunct Professor, School of Business, Georgetown University, 1994-1995.

Adjunct Professor, School of Business Administration, George Mason University, Fairfax, Virginia, 1991-1994.

Adjunct Professor, Pamplin College of Business, Virginia Polytechnic Institute, Falls Church Virginia, 1990.

Assistant Professor of Finance, School of Management, The University of Texas at Dallas, 1984 - 1989.

PRIVATE POSITIONS

Consultant, Strategic Petroleum, Inc., Dallas, TX (a joint venture between the principals of Chicago Research and Trading and Tradelink, LLC). 1988-1989.

Applied option pricing theory to valuation decisions concerning drilling and abandonment of operating wells. Validated models used to analyze arbitrage strategies involving spot crude oil and exchange-traded crude oil futures and options.

LITIGATION AND ENFORCEMENT MATTERS

Dr. Overdahl has consulted on more than 50 enforcement matters before the CFTC and SEC over a 20-year period. He has performed work on establishing materiality of misstatements or omissions in disclosures surrounding the issuance of securities, estimating damages in issuer penalty cases, 10b-5 cases, insider trading, and commodity price manipulation. He has worked on matters involving the alleged false reporting of transactions to index providers in the natural gas industry, price manipulation in thinly traded cash markets with related futures markets, bidding misbehavior surrounding auctions of treasury debt, counterparty duties in over-the-counter derivatives transactions, alleged manipulation of propane and gasoline products, mutual fund late trading, valuation of swap contracts, calculation of margin amounts, dilution of mutual fund and hedge fund assets. He also assisted the U.S. Attorney's Office in developing evidence for criminal cases resulting from SEC referrals to the Justice Department, and he assisted the Division of Enforcement at both the SEC and CFTC in devising sanctions and evaluating settlement terms. He also has worked on evaluating fair-fund distribution plans. In private practice he has worked on matters involving alleged short-sale price manipulation, swap valuation, insider trading, futures block transactions, and market manipulation.

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BOARD AND ADVISORY POSITIONS

Board of Directors, Futures Industry Association (Public Director). (2016-2018).

American Bar Association, Antitrust Section, Insurance and Financial Services Committee Advisory Board. (2010-present).

Center for the Study of Financial Regulation, Mendoza College of Business, University of Notre Dame. (2011-present).

SEC Historical Society Advisory Board (2013-2016)

Advisory Board Member, Inveniam Capital Partners, (2020-present)

CONGRESSIONAL TESTIMONY

"Implementing Dodd-Frank: A Review of the CFTC's Rulemaking Process," United States House of Representatives, Committee on Agriculture, Subcommittee on General Farm Commodities and Risk Management, April 13, 2011.

"The Costs of Implementing the Dodd-Frank Act: Budgetary and Economic," United States House of Representatives, Committee on Financial Services, Oversight and Investigations Subcommittee, March 30, 2011.

"Reducing Risks and Improving Oversight in the OTC Credit Derivatives Market," United States Senate, Committee on Banking, Housing, and Urban Affairs, Subcommittee on Securities, Insurance, and Investment, July 9, 2008.

"Hedge Funds and Systemic Risk: Perspectives of the President's Working Group on Financial Markets," United States House of Representatives Committee on Financial Services. July 11, 2007.

"The Role of Hedge Funds in our Capital Markets," United States Senate, Committee on Banking, Housing, and urban Affairs, Subcommittee on Securities, Insurance, and Investment. May 16, 2006.

"Global Oil Demand and Gasoline Prices," United States Senate Committee on Energy and Natural Resources, Full Committee Hearing. September 6, 2005.

EXPERT WITNESS TESTIMONY

In the matter of *Fairfax Financial Holdings Limited and Crum & Foster Holdings Corp.* v. *S.A.C Capital Management, LLC*, et. al. (July, 2011).

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In the Matter of Christopher M. Gibson, Securities and Exchange Commission Administrative Proceeding No. 3-17184. (September, 2016).

In the Matter of William Tirrell, Securities and Exchange Commission Administrative Proceeding No. 3-17313. (September, 2017).

In the Matter of Commodity Futures Trading Commission v. Kraft Foods Group, Inc. and Mondelez Global, LLC, Case No. 15 C 2881 (Ongoing).

In the Matter of Harry Ploss, as Trustee for the Harry Ploss Trust Dated 8/16/1993, on behalf of Plaintiff and all others similarly situated v. Kraft Foods Group, Inc. and Mondlez Global LLC, Proceeding No. 15-cv-2937 United States District Court Northern District of Illinois (ongoing).

Michael Schaufler v. Well Fargo Bank, N.A., et al. Superior Court of California—County of San Francisco. (Verdict returned on January 24, 2020).

SELECTED PUBLICATIONS

A. Books

Financial Derivatives: Pricing and Risk Management (With Robert Kolb), Wiley-Blackwell Publishers, 2010.

Futures, Options, and Swaps, Fifth Edition (With Robert Kolb), Blackwell Publishers, Oxford: 2007.

Understanding Futures Markets, Sixth Edition (With Robert Kolb), Blackwell Publishers, Oxford: 2006.

Financial Derivatives, Third Edition (With Robert Kolb), Wiley Publishers, New York: 2003.

B. Journal Articles and Book Chapters

"Automated Trading Systems and the Current Regulatory Framework," with Kwon Park, forthcoming, *Algorithmic Finance*, 2016.

"The Exercise of Anti-Spoofing Authority in U.S. Futures Markets: Policy and Compliance Consequences," with Kwon Park, *Futures and Derivatives Law Report*, Volume 36, Issue 5, May, 2016.

"Implied Matching Functionality in Futures Markets," *Futures Industry Magazine*, November, 2011.

"Derivative Contracts and Their Regulation," (with Robert Zwirb), in *Financial Product Fundamentals*, Clifford E. Kirsch, editor, Practicing Law Institute: New York, 2015.

"Evidence-Based Regulatory Policy Making for Financial Markets," (with Frederick H. DEB Harris, Michael J. Aitken, Alfred R. Berkeley, and Kumar Venkataraman), *Journal of Trading*, Institutional Investor Journals, Spring, 2011.

"Derivative Contracts: Futures, Options, and Swaps," in *Finance Ethics: Critical Issues in Financial Theory and Practice,* John Boatright, editor, Wiley-Blackwell Publishers, Spring 2010.

"Counterparty Credit Risk," in *Financial Derivatives: Insights and Analysis on Modern Risk Management and Pricing,* Wiley-Blackwell Publishers, Fall 2009.

"Hedge Funds, Volatility and Liquidity Provision in Energy Futures Market" (with Michael Haigh and Jana Hranaiova), *Journal of Alternative Investments,* Spring, 2007.

Encyclopedia of Business, Ethics, and Society, Sage Publishing Company. Articles in the *Encyclopedia*: "Ronald H. Coase," "Coase Theorem," "Market Transparency," "Barings Bank," "Metallgesellschaft," "Bankers Trust," "Comptroller of the Currency," and "Securities and Exchange Commission," 2008.

"Derivatives Market Innovation and the Commodity Futures Modernization Act," with Sharon Brown-Hruska, *The Euromoney Derivatives and Risk Management Handbook, 2005/2006*.

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"Option Exercises: Evidence From the Treasury Bond Futures Option Market," (with Jin Choi), *Advances in Futures and Options Research*, 1991.

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"The Use of Crude Oil Futures by the Governments of Oil-Producing States," *Journal of Futures Markets*, Winter, 1987.

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"An Empirical Examination of the T-Bond Futures (Call) Options Market," (with Larry Merville), *Advances in Futures and Options Research*, 1986.

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"SEC Settlements Trends: 1H12 Update," with Elaine Buckberg. NERA publication, June 27, 2012.

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"Will court short-circuit Dodd Frank?" With Jonathan Macey and Elaine Buckberg, *Politico*, August 15, 2011.

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Exhibit B

THE NATIONAL LAW JOURNAL
AUGUST 20, 2020
An ALM Publication

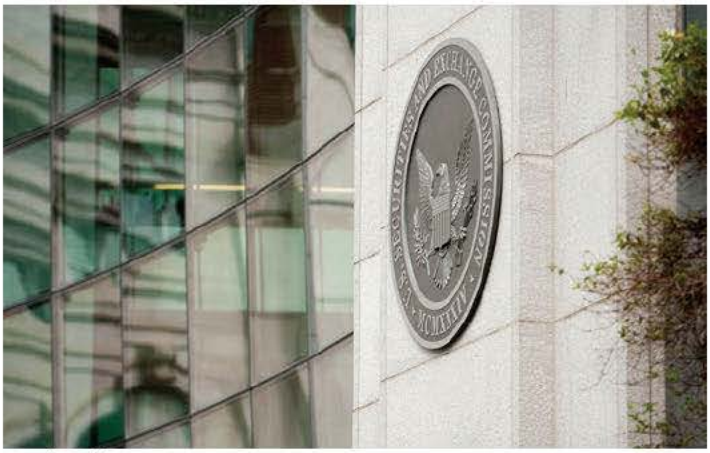
Aggressive SEC Enforcement Actions Could Limit Small Business Recovery Resources

The commission's Enforcement Division has waged an overly aggressive and entirely unnecessary campaign against the very firms that provide capital and liquidity to the small businesses the SEC says it wants to help.

BY **HELGI WALKER, BARRY GOLDSMITH, JONATHAN SEIBALD AND BRIAN RICHMAN**

In recent public statements, the chair and other commissioners of the Securities and Exchange Commission have struck the right chord: they have vowed to leverage every tool in their regulatory tool kit to facilitate the flow of capital to the thousands of small businesses that are struggling to stay afloat in the wake of the COVID-19 pandemic. However, contrary to the SEC's stated priorities, the commission's enforcement division has waged an overly aggressive and entirely unnecessary campaign against participants in the market for convertible debt—the very firms that provide capital and liquidity to the small businesses the SEC says it wants to help. Witness *SEC v. Fierro* in the U.S. District Court for the District of New Jersey, or *SEC v. Keener* and *SEC v. Almagarby* in the U.S. District Court for the Southern District of Florida.

In these litigated enforcement actions, the enforcement division has taken the novel position that various lenders in the shares of convertible debt—firms that do not directly interact with the investing public—are actually "dealers" subject to the full range of registration and other regulatory requirements applicable to public securities businesses. Why? Because some borrowers opt to satisfy their outstanding debt by allowing the lender to convert that debt into discounted shares of stock in the borrower, which the lender under SEC regulations can sell after waiting six months. The enforcement division insists that this well-established activity satisfies the definition of a dealer because the lender is "buying and selling securities" for its "own account."



SEC headquarters

That is just wrong. The division's theory would not only sweep in thousands of unsuspecting businesses that buy and sell securities; it breaks with the plain terms of the Securities Exchange Act, over a century of precedent and decades of the commission's own guidance. A dealer is a known quantity under our nation's securities laws, and no one—including the SEC—has ever thought that the term referred to any business that just so happened to buy and sell securities, even a lot of securities. Quite the contrary. The term distinguishes a particular, preexisting type of public securities business—a dealer—from another type of preexisting public securities

business—a "broker." Such businesses occupy two sides of the same coin. Under the Exchange Act, while a broker effectuates a client's trades as an agent—buying and selling securities for the client—a dealer effectuates a client's trades as a principal—buying and selling securities from or to the client.

Either way, the key is public customers. Many individuals and businesses trade securities—but only a broker or a dealer holds itself out to the investing public as a public securities business. The commission has long recognized as much. In 1992, for instance, in *In re Gordon Wesley Sodorff Jr.*, the commission acknowledged that certain "factors"—such as handling investors' money and securities, rendering investment advice and sending "subscription agreements to investors for their review and signature"—are what "distinguish[ed] the activities of a dealer from those of a private investor or trader." SEC guidance has made the same point for decades—listing similar customer-facing factors in, for example, 1977, 1987, 1993, 1998, 2002, 2003, 2007 and 2008. And the courts have long agreed, as the U.S. District Court for the Northern District of Texas explained in 2016, in *Chapel Investments v. Cherubim Interests*: "To be considered a dealer, a person must be engaged in the securities business, such as soliciting investor clients, handling investor clients' money and securities, rendering investment advice to investors, and sending investors subscription agreements for their review and execution."

This customer focus is not just compelled by the law, but by sound public policy. Dealers, after all, are subject to an expensive, complex regulatory regime designed to protect investors, including standards of professional conduct, financial responsibility requirements, record-keeping requirements and employee-supervisory obligations. Which is all well and good for entities with customers, but entirely nonsensical for businesses without that just happen to buy and sell securities for their own account.

For these reasons, convertible debt lenders are not—and, before the Enforcement Division's misguided enforcement endeavor, have never been—considered dealers. A convertible debt lender, as the name implies, loans money to a small business in exchange for a convertible note. It is not, to quote the Exchange Act, in the "regular business" of "dealing." It does not "buy[ ] and sell[ ]" the same security in the same condition. It does not interact with the investing public. It does not hold investor's securities. It does not quote a two-way market. And it does not offer investment advice—to anyone, ever. In no world, then, is it engaged in the public-facing business of offering dealer services to others.

That should end the matter. The Enforcement Division should never try to change the law (not to mention the commission's long-standing guidance) through regulation by enforcement, outside the proper legislative or rulemaking processes. That is especially true here, where the Enforcement Division's targeting of vital financing providers threatens to take much-needed capital out of the convertible debt markets, squeezing small businesses and introducing a level of regulatory uncertainty that would be inappropriate in the best of times—and we are far from that. If the Enforcement Division really believes that convertible debt lenders are dealers just because their business involves buying and selling securities, who is next? Hedge funds? Investment companies? Day traders?

Consistent with its stated goal of supporting small businesses during the pandemic, and in order to adhere to the long-established meaning of "dealer" under the federal securities laws, the commission should rein in the Enforcement Division's misguided campaign against those who provide much-needed capital to small businesses through the convertible debt market.

Helgi Walker *is a partner at Gibson, Dunn & Crutcher and chair of the firm's administrative law and regulatory practice group. Barry Goldsmith is a partner at the firm and co-chair of the firm's securities enforcement practice group. Jonathan Seibald and Brian Richman are associates at the firm.*

Exhibit C

GIBSON DUNN

Gibson, Dunn & Crutcher LLP

200 Park Avenue
New York, NY 10166-0193
Tel 212.351.4000
www.gibsondunn.com

Barry Goldsmith
Direct: +1 212.351.2440
Fax: +1 212.351.5340
BGoldsmith@gibsondunn.com

September 21, 2020

VIA ELECTRONIC MAIL

Office of FOIA Services
U.S. Securities and Exchange Commission
100 F Street, NE
Mail Stop 2465
Washington, D.C. 20549

Re: Freedom of Information Act Request

Dear Sir or Madam:

This is a request pursuant to the Freedom of Information Act. Pursuant to this authority, I request that copies of the following records be provided to me:

1. Complaints from individual investors, or their representatives, received by the Securities and Exchange Commission's Office of Investor Education and Advocacy from 2015 to the present relating to convertible promissory notes issued by microcap (also known as small-cap or penny stock) issuers; and

2. Complaints from individual investors, or their representatives, received by the Securities and Exchange Commission's Office of Investor Advocate from 2015 to the present relating to convertible promissory notes issued by microcap (also known as small-cap or penny stock) issuers.

We agree to pay the reasonable costs and fees associated with this request. Please deliver the requested records to me at:

Barry Goldsmith, Esq.
Gibson, Dunn & Crutcher LLP
200 Park Avenue
New York, NY 10166

If the requested records do "not exist" or "cannot be located," please notify me in writing of that determination. 17 C.F.R. § 200.80(e)(iii). If you otherwise deny this request in whole or in part, please respond in writing and state the statutory exception authorizing the

withholding of all or part of the public record. *Id.* § 200.80(e)(iv)(B). In the event only some portions of the requested records are properly exempt from disclosure, please disclose any reasonably segregable non-exempt portions of the requested records. 5 U.S.C. § 552(b). If it is your position that the entirety of the requested records are properly exempt from disclosure or that it is not reasonable to segregate portions of such records for release, please "estimate the volume of any records or information withheld by providing the number of pages withheld in their entirety." 17 C.F.R. § 200.80(e)(iv)(D).

Thank you for your prompt response to this request. We look forward to your determination of this request within twenty business days. 5 U.S.C. § 552(a)(6)(A); 17 C.F.R. § 200.80(d)(2). If you have any questions, please contact me by email at BGoldsmith@gibsondunn.com or by phone at 212.351.2440.

Respectfully,

/s/ Barry Goldsmith

Barry Goldsmith

Exhibit D

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
STATION PLACE
100 F STREET, NE
WASHINGTON, DC 20549-2465

Office of FOIA Services

December 17, 2020

Mr. Barry Goldsmith
Gibson Dunn & Crutcher LLP
200 Park Avenue
New York, NY 10166

Re: Freedom of Information Act (FOIA), 5 U.S.C. § 552
Request No. **20-02102-FOIA**

Dear Mr. Goldsmith:

This letter is in response to your request, dated and received in this office on September 21, 2020, for:

1. Complaints from individual investors, or their representatives, received by the Securities and Exchange Commission's Office of Investor Education and Advocacy from 2015 to the present relating to convertible promissory notes issued by microcap (also known as small-cap or penny stock) issuers; and

2. Complaints from individual investors, or their representatives, received by the Securities and Exchange Commission's Office of Investor Advocate from 2015 to the present relating to convertible promissory notes issued by microcap (also known as small-cap or penny stock) issuers.

Via email on November 20, 2020, you asked that we provide the complaints as well as any responses or documents related to the complaints.

Your request is granted in part. We are releasing 60 pages with this letter except for portions withheld under FOIA Exemption 6. We are withholding additional records in full in accordance with FOIA exemptions 3, 6, 7(A), 7(C), and (7)(D), 5 U.S.C. § 552(b) (3), (6) and (7) , 17 CFR § 200.80(b)(3), (6) and (7)(iii), for the following reasons.

Under Exemption 3, certain responsive information is specifically exempted from disclosure by statute. Pursuant to 15 USC § 78u-6, the Commission shall not disclose any information,

including information provided by a whistleblower to the Commission, which could reasonably be expected to reveal the identity of a whistleblower.

Under Exemption 6, the release of this type of information would constitute a clearly unwarranted invasion of personal privacy.

Under Exemption 7(A), release of this information could reasonably be expected to interfere with enforcement activities.

Under Exemption 7(C), the release of the information could reasonably be expected to constitute an unwarranted invasion of personal privacy. Further, public identification of Commission staff could conceivably subject them to harassment in the conduct of their official duties and in their private lives.

Under Exemption 7(D), release of this information could reasonably be expected to disclose the identity of a confidential source which furnished information on a confidential basis.

I am the deciding official with regard to this adverse determination. You have the right to appeal my decision to the SEC's General Counsel under 5 U.S.C. § 552(a)(6), 17 C.F.R. § 200.80(f)(1). The appeal must be received within ninety (90) calendar days of the date of this adverse decision. Your appeal must be in writing, clearly marked "Freedom of Information Act Appeal," and should identify the requested records. The appeal may include facts and authorities you consider appropriate.

You may file your appeal by completing the online Appeal form located at https://www.sec.gov/forms/request_appeal, or mail your appeal to the Office of FOIA Services of the Securities and Exchange Commission located at Station Place, 100 F Street NE, Mail Stop 2465, Washington, D.C. 20549, or deliver it to Room 1120 at that address.

If you have any questions, please contact Amy Gbenou of my staff at Gbenoua@sec.gov or (202) 551-5327. You may also contact me at foiapa@sec.gov or (202) 551-7900. You may also

contact the SEC's FOIA Public Service Center at foiapa@sec.gov or (202) 551-7900. For more information about the FOIA Public Service Center and other options available to you please see the attached addendum.

Sincerely,

Carrie Hyde-Michaels

Carrie Hyde-Michaels
FOIA Branch Chief

Enclosures

ADDENDUM

For further assistance you can contact a SEC FOIA Public Liaison by calling (202) 551-7900 or visiting https://www.sec.gov/oso/help/foia-contact.html.

SEC FOIA Public Liaisons are supervisory staff within the Office of FOIA Services. They can assist FOIA requesters with general questions or concerns about the SEC's FOIA process or about the processing of their specific request.

In addition, you may also contact the Office of Government Information Services (OGIS) at the National Archives and Records Administration to inquire about the FOIA dispute resolution services it offers. OGIS can be reached at 1-877-684-6448 or via e-mail at ogis@nara.gov. Information concerning services offered by OGIS can be found at their website at Archives.gov. Note that contacting the FOIA Public Liaison or OGIS does not stop the 90-day appeal clock and is not a substitute for filing an administrative appeal.

File (b)(6)

Incoming Complaint – Phone Call:

Correspondent Name: Mr. (b)(6)
Create Date: 7/1/2015
Origin: Phone
File #: (b)(6)
(b)(6)

7/1/2015 - The correspondent called and stated he (b)(6) for an OTC issuer and he had questions regarding convertible promissory notes in regards to (b)(6). The correspondent was directed to the SEC's Division of Corporation Finance and he was provided with the contact telephone for (b)(6) line of business.

File (b)(6)

Incoming Complaint:

Correspondent Name: Mr. (b)(6)
Create Date: 9/2/2015
Origin: Web
File #: (b)(6)

Send to Entity:

Investor Information
Name: (b)(6)

Address:

,

Day Phone: (b)(6)
Alt Phone:
Fax:
Email: (b)(6) .com

Entity Information
Name:
Type:
Representative:
Address:

,

Security Information
Name:
Symbol:
Type:

Description:
(b)(6) a company that is a publicly reporting company that has significant assets and income. Recently it entered into a convertible promissory note transaction with an accredited investor and conversions of debt into shares of common stock have occurred. The number of shares resulting from the conversion and the amount of the debt are both insignificant in terms of the number of shares converted compared to the number of issued and outstanding shares and the dollar amount of the debt when compared to income and assets. The company does not want to file a Form D. Must it file a Form D? Thank you in advance for your assistance.

Acknowledgment to Correspondent:

From: Help [help@sec.gov]
Sent: 9/2/2015 1:39 PM
To: (b)(6) com
Subject: SEC Response

Dear (b)(6)

Thank you for submitting your online contact to the Securities and Exchange Commission's Office of Investor Education and Advocacy. A representative of the Office of Investor Education and Advocacy will respond to you shortly.

In order to ensure that you receive your subscription e-mails and announcements from the SEC, please add us to your contact list, adjust your spam settings, or follow the instructions from your e-mail provider on how to prevent our e-mails from being marked "Spam" or "Junk Mail."

Please do not reply to this message directly.

Thank you,
Office of Investor Education and Advocacy

Response to Correspondent:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 9/3/2015 9:39 AM
To: (b)(6) com
Subject: SEC Response (b)(6)

(b)(6)

Dear (b)(6)

Thank you for contacting the U.S. Securities and Exchange Commission (SEC).

Your concerns are best addressed by our Division of Corporation Finance. Please contact that division directly at (202) 551-3500 or by submitting a Request Form for Interpretive and Other Assistance at https://tts.sec.gov/cgi-bin/corp_fin_interpretive. If you submit the webform, please provide a telephone number so that a staff member may respond to your inquiry by phone. Also, should you wish to consult with private legal counsel and need help finding a lawyer, please visit http://www.sec.gov/answers/lawref.htm .

Please feel free to contact me if you have other questions.

Sincerely,

(b)(6)

Office of Investor Education and Advocacy
U.S. Securities and Exchange Commission
(800) 732-0330
http://www.sec.gov
www.investor.gov
www.twitter.com/SEC_Investor_Ed

File Attachment:
Correspondent Name: (b)(6)
Create Date: 2015-09-02 17:39:19
Origin: Web
File #: (b)(6)
Description:
(b)(6) a company that is a publicly reporting company that has significant assets and income. Recently it entered into a convertible promissory note transaction with an accredited investor and conversions of debt into shares of common stock have occurred. The number of shares resulting from the conversion and the amount of the debt are both insignificant in terms of the number of shares converted compared to the number of issued and outstanding shares and the dollar amount of the debt when compared to income and assets. The company does not want to file a Form D. Must it file a Form D? Thank you in advance for your assistance.

(b)(6)

File HO-00562245

Incoming Complaint:

Correspondent Name: Mr. (b)(6)
Create Date: 3/1/2016
Origin: Web
File #: (b)(6)

Send to Entity:

Investor Information
Name: (b)(6)

Address:

Day Phone: (b)(6)
Alt Phone:
Fax:
Email: (b)(6);(b)(7)(C)@gmail.com

Entity Information
Name:
Type:
Representative:
Address:

Security Information
Name:
Symbol:
Type:

Description:
I have invested in an OTC Pink stock (TPAC) and the most recent 10-K report had this statement in it.

"On November 20, 2013, we entered into a Promissory Note Agreements with JMJ Financial, pursuant to which we sold to JMJ a Convertible Promissory Note in the total principal amount of $335,000 with a consideration of $300,000 (the "JMJ Note"). The difference of $35,000 is stated as original issue discount (the "OID"). JMJ paid $25,000 of consideration upon closing of this Note and another $25,000 on April 16, 2014. These were the only funds received by the Company during the nine months ended July 31, 2014. JMJ may pay additional consideration to the Company in such amounts and at such dates as JMJ may choose in its sole discretion. The maturity date is two years from the effective date of each payment. JMJ Note is convertible into our common stock at the greater of (i) the Variable Conversion Price and (ii) the Fixed Conversion Price. The "Variable Conversion Price" shall mean 60% multiplied by the Market Price (representing a discount rate of 40%). "Market Price" means the average of the lowest Trading Price for the Common Stock during the 25 Trading Days prior to the Conversion Date. "Fixed Conversion Price" shall mean $0.00009. The shares of common stock issuable upon conversion of the JMJ Note will be restricted securities as defined in Rule 144 promulgated under the Securities Act of 1933. The issuance of the JMJ Note was exempt from the registration requirements of the Securities Act of 1933 pursuant to Rule 506 of Regulation D promulgated thereunder. The purchaser was an accredited and sophisticated investor, familiar with our operations, and there was no solicitation."

My question is, based on this statement, did TPAC need to file a Form D? I do not see one on the Edgar listing page for TPAC.

Acknowledgment to Correspondent:

From: Help [help@sec.gov]
Sent: 3/1/2016 1:12 PM
To: (b)(6) @gmail.com
Subject: SEC Response

Dear (b)(6)

Thank you for submitting your online contact to the Securities and Exchange Commission's Office of Investor Education and Advocacy. A representative of the Office of Investor Education and Advocacy will respond to you shortly.

In order to ensure that you receive your subscription e-mails and announcements from the SEC, please add us to your contact list, adjust your spam settings, or follow the instructions from your e-mail provider on how to prevent our e-mails from being marked "Spam" or "Junk Mail."

Please do not reply to this message directly.

Thank you,
Office of Investor Education and Advocacy

Response to Correspondent:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 3/30/2016 5:29 PM
To: (b)(6);(b)(7) @gmail.com
Subject: SEC Response (b)(6)

Dear (b)(6)

Thank you for contacting the U.S. Securities and Exchange Commission (SEC).

You ask whether Trans-pacific Aerospace Company, Inc. (TPAC) was required to file a Form D based on its statement in a Form 10-K that it issued a note to JMJ Financial pursuant to the Rule 506 exemption of Regulation D. We note that TPAC made that statement in its Form 10-K filed 2/13/2015 for its fiscal year ended Oct. 31, 2014 (https://www.sec.gov/Archives/edgar/data/1422295/000101968715000579/tpac_10k-103114.htm)

The filing of a Form D is a requirement of Rule 503(a) of Regulation D, but it is not a condition to the availability of the exemption under Rule 506 of Regulation D. For further discussion of this issue, please refer to the Compliance and Disclosure Interpretations (C&DIs) by the Division of Corporation Finance at https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm. Your question is addressed in question 257.07 of the C&DIs.

Please contact me if you have additional questions.

(b)(6)
Office of Investor Education and Advocacy
U.S. Securities and Exchange Commission
(800) 732-0330
http://www.sec.gov
www.investor.gov
www.twitter.com/SEC_Investor_Ed

File Attachment:
Correspondent Name: Mr. (b)(6)
Create Date: 2016-03-01 18:12:44
Origin: Web
File #: (b)(6)
Description:
I have invested in an OTC Pink stock (TPAC) and the most recent 10-K report had this statement in it. "On November 20, 2013, we entered into a Promissory Note Agreements with JMJ Financial, pursuant to which we sold to JMJ a Convertible Promissory Note in the total principal amount of $335,000 with a consideration of $300,000 (the "JMJ Note"). The difference of $35,000 is stated as original issue discount (the "OID"). JMJ paid $25,000 of consideration upon closing of this Note and another $25,000 on April 16, 2014. These were the only funds received by the Company during the nine months ended July 31, 2014. JMJ may pay additional consideration to the Company in such amounts and at such dates as JMJ may choose in its sole discretion. The maturity date is two years from the effective date of each payment. JMJ Note is convertible into our common stock at the greater of (i) the Variable Conversion Price and (ii) the Fixed Conversion Price. The "Variable Conversion Price" shall mean 60% multiplied by the Market Price (representing a discount rate of 40%). "Market Price" means the average of the lowest Trading Price for the Common Stock during the 25 Trading Days prior to the Conversion Date. "Fixed Conversion Price" shall mean $0.00009. The shares of common stock issuable upon conversion of the JMJ Note will be restricted securities as defined in Rule 144 promulgated under the Securities Act of 1933. The issuance of the JMJ Note was exempt from the registration requirements of the Securities Act of 1933 pursuant to Rule 506 of Regulation D promulgated thereunder. The purchaser was an accredited and

sophisticated investor, familiar with our operations, and there was no solicitation." My question is, based on this statement, did TPAC need to file a Form D? I do not see one on the Edgar listing page for TPAC.
(b)(6)

Email from Correspondent:

From: (b)(6) @gmail.com]
Sent: 3/30/2016 5:35 PM
To: help@sec.gov
Subject: Re: SEC Response (b)(6)

Ms. (b)(6)

Thank you for your time, effort, and clarification of this matter.

Sincerely,

(b)(6)

File (b)(6)

Incoming Complaint:

Correspondent Name: Mr. (b)(6)
Create Date: 9/21/2017
Origin: Web
File #: (b)(6)

Send to Entity:

Investor Information
Name: (b)(6)

Address:

,

Day Phone:
Alt Phone:
Fax:
Email (b)(6) @yahoo.com

Entity Information
Name:
Type:
Representative:
Address:

,

Security Information
Name:
Symbol:
Type:

Description:
I need to file a complaint for my family against both a registered broker and a listed company. Can I file both with the SEC or must I file separately with the SEC and FINRA? There are five family members involved. Can we file jointly or must each be a separate complaint. Thank you.

Acknowledgement to Correspondent:

From: Help [help@sec.gov]
Sent: 9/21/2017 10:29 AM
To: (b)(6) @yahoo.com
Subject: SEC Response

Dear (b)(6)

Thank you for submitting your online contact to the Securities and Exchange Commission's Office of Investor Education and Advocacy. A representative of the Office of Investor Education and Advocacy will respond to you shortly.

In order to ensure that you receive your subscription e-mails and announcements from the SEC, please add us to your contact list, adjust your spam settings, or follow the instructions from your e-mail provider on how to prevent our e-mails from being marked "Spam" or "Junk Mail."

Please do not reply to this message directly.

Thank you,
Office of Investor Education and Advocacy

Consent Request to Correspondent:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 9/21/2017 5:09 PM
To: (b)(6) @yahoo.com
Subject: SEC Consent to Contact Firm - File (b)(6)

(b)(6)

Dear (b)(6),

Thank you for contacting the U.S. Securities and Exchange Commission (SEC).

Please feel free to file your complaint with the SEC regarding the broker and company. It would be easier to outline the complaint process by calling me directly at (b)(6) since this involves 5 family members and possibly separate accounts.

Generally, upon receipt of this type of complaint, our office contacts the compliance department of the firm involved, requesting that the firm review the matter and provide a written response to the complaint. If you would like us to contact the firm about your concerns, we require written authorization to contact the firm.

In the interim, you may want to review our brochure on how the SEC handles investor complaints, available at https://investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-bulletin-investor-complaints.

I look forward to speaking with you regarding your complaint(s).

Sincerely,

(b)(6)

Office of Investor Education and Advocacy
U.S. Securities and Exchange Commission
(800) 732-0330
www.sec.gov
www.investor.gov
www.twitter.com/SEC_Investor_Ed
(b)(6)

Email from Correspondent:

From: (b)(6) (b)(6) @yahoo.com]
Sent: 9/28/2017 4:35 PM
To: help@sec.gov
Subject: Re: SEC Consent to Contact Firm - File (b)(6)

I filed an online complaint to the SEC website today.
Thanks for your help.

Response to Correspondent:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 9/29/2017 8:30 AM
To: (b)(6) @yahoo.com
Subject: Re: SEC Consent to Contact Firm - File (b)(6)

(b)(6)

(b)(6)

I am in receipt of your voicemail message as well as the online complaint. I will be in the process of reviewing the matter and will contact you soon.

Thanks.
(b)(6)

Email from Correspondent:

From: [(b)(6) @yahoo.com]
Sent: 9/29/2017 9:02 AM
To: help@sec.gov
Subject: Re: SEC Consent to Contact Firm - File (b)(6)

Thank you

Response to Correspondent:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 9/29/2017 2:27 PM
To: (b)(6) @yahoo.com
Subject: SEC Response - File (b)(6)

(b)(6)

Dear Mr. (b)(6) Family:

This is to confirm receipt of your complaint dated September 21, 2017, against DAWSON JAMES SECURITIES, INC., and Mr. (b)(6) concerning your private placement offering in Pareteum Corp., formerly, Elephant Talk Communications, Inc, We have forwarded your complaint to Dawson James' Compliance Department and asked that it respond directly to you, with a copy to our office. Please allow two to three weeks for this process to take place.

Our efforts to facilitate informal resolutions of complaints frequently succeed. In some cases, however, a firm may deny wrongdoing or it may remain unclear whether any wrongdoing occurred. If that happens, we cannot act as your personal representative or attorney. Instead, it will be for you to decide whether to pursue legal action on your own. Enclosed is information on steps you may wish to consider including arbitration and mediation, and sources of potential legal assistance. Please read these documents carefully. They describe your rights and important deadlines.

If you have any questions, please contact me.

Sincerely,

(b)(6)

Office of Investor Education and Advocacy
U.S. Securities and Exchange Commission
(800) 732-0330
www.sec.gov
www.investor.gov
www.twitter.com/SEC_Investor_Ed

STEPS FOR PURSUING A COMPLAINT

Know your legal rights

You should know your legal rights and be prepared to take action on your own, even while waiting for the firm's response. Federal and state securities laws allow you to start legal proceedings against those who may be engaged in wrongdoing. If you believe the firm's response inaccurate or incomplete, consider writing a second letter to the firm, laying out the problems with the firm's response and including copies of documents that support your views.

Act promptly

Time restrictions, called "statutes of limitations," require you to begin legal action promptly. For example, the federal securities laws require you to bring action within two years of the date you reasonably should have discovered the wrongdoing, but no later than five years from the date it occurred. If you sue any later, you may lose the right to recover. Limitations vary from state to state and may differ depending on whether you claim a violation of state law or federal law.

Use arbitration, if agreed to

When you opened your brokerage account, you probably agreed to use arbitration (and only arbitration) to settle all disputes with your broker or the firm. But even if you did not, you may choose to use arbitration to settle disputes. If you use arbitration, arbitrators will apply either a federal or state statute of limitations, depending on the nature of your claim. You generally cannot pursue an issue through arbitration if it is more than six years old. For older cases, you will probably want to consult with an attorney. When deciding whether to arbitrate — or, if it is a choice, to sue in court — bear in mind that if your broker or brokerage firm goes out of business or declares bankruptcy, you might not be able to recover your money — even if the arbitrator or court rules in your favor.

Learn about low-cost arbitration

If you use Financial Industry Regulatory Authority and your claim is $25,000 or less, you generally will not have to appear in person at a hearing and an arbitrator will make a decision on your case by reviewing documents and written descriptions of what happened from you and your broker. You should carefully review the rules governing simplified arbitration before filing a claim. To obtain information about arbitration procedures, please go to: http://www.finra.org/. Again, you should weigh the costs of arbitrating against the likelihood of being able to collect any award, especially if the brokerage firm has left the industry or gone bankrupt. Firms that stay in business typically pay the arbitration awards levied against them, but defunct firms may not.

Consider Mediation

Mediation is also an option you should consider before going to arbitration. Mediation allows you to save time and money because it is quicker than arbitration and voluntary. If you can't reach an agreement through mediation, you can still go to arbitration. To learn about mediation, please go to: http://www.finra.org/.

If you decide to hire a lawyer and need help in finding one, please go to: http://www.sec.gov/answers/lawref.htm. Remember you do not have to have a lawyer to file an arbitration claim.

(b)(6)

Request to Entity:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 9/29/2017 2:28 PM
To: (b)(6) @dawsonjames.com
Subject: Investor Complaint - File (b)(6)

Dear Compliance Officer:

We have received the attached complaint from one of your firm's clients. Please analyze the complaint carefully and prepare a written response addressing the issues raised. Your response should describe the actions you are taking in response to the complaint. If appropriate, please provide supporting documentation.

Please send your response to the client, with a copy to our office, within 14 days of your receipt of this letter. If you cannot meet this deadline, please let me know.

You may respond to me by email at help@sec.gov, by fax at (202) 772-9293, or by mail at the address shown below. Please be aware that we are unable to access secure web email accounts hosted by regulated entities. If you intend to submit a response to the SEC via encrypted email, please review the SEC External Guide for Using the E-mail Encryption Solution at http://www.sec.gov/about/offices/ocie/secureemailguide.pdf and create an account on our server.

Please review SEC Form 2405 (www.sec.gov/about/forms/sec2405.pdf) in preparing your response.

If you have any questions, please contact me.

Sincerely,

(b)(6)

U.S. Securities and Exchange Commission
Office of Investor Education and Advocacy
100 F Street, NE – Mail Stop 2-13
Washington, DC 20549-0213
Direct: (b)(6)
Fax: (202) 772-9295
Email: (b)(6) @sec.gov
(b)(6)

Web Form Information

File Number	(b)(6)	Web Email	(b)(6) @yahoo.com
		Yes Send to Company or Firm	✓
No Do Not Send to Firm		Are You A	Individual Investor
Fax		Alternate Phone	
		Daytime Phone	(b)(6)
		Contact Title	Mr.
Contact First Name	(b)(6)	Contact Middle Initial	(b)(
Contact Last Name		Contact Street Address	85
Contact Street Address Cont	(b)(6)	Contact City	
Contact State/Province		Contact Zip/Postal code	
Contact Country		Firm Name	Dawson James Securities
Type of Firm		Broker, Advisor, Salesperson	(b)(6)
		Firm/Person Address	530
Firm/Person Address Cont		Firm/Person City	New York
Firm/Person State/Province	(b)(6)	Firm/Person Zip/Postal Code	10036
Firm/Person Country		Type of Security	Promissory notes, loans, IOUs
Name of Issuer or Security		Security Symbol	TEUM
		Canceled Checks	
Correspondence to/from Firm	✓	Advertising/Marketing Materials	✓
Notes of Conversation w/Firm	✓	Other	✓
Other Documents	emails	Complained to Firm	Yes
Contacted Other Regulators	No	FINRA	
State Regulators		Other Federal Regulators	
Foreign Regulators		Stock Exchange	
Stock Exchange Symbol		Other Regulator	
Other Regulator Text		Legal Action - Mediation	
Legal Action - Arbitration		Legal Action - Court Action	
		Legal Action Details	

		Privacy Notice	
Privacy Too Long		**Privacy Typeface Too Small**	
Opt Out Notice		**Complex Opt Out Procedure**	
Unable to Opt Out		**Improper Personal Finance Info**	
Unauthorized Access		**Adequate Safeguards**	
Able to send Privacy/Opt Out		**Other Privacy**	
Invalid Email			

Description

(b)(6)

In the 1st Quarter of 2016 (approximately January, 2016) the (b)(6) Investors" each invested thirty-thousand ($30,000) towards the Elephant Talk Communications Corp.'s ("ETAK") private placement offering ("the Offering") of "Units"1. The (b)(6) Investors" were advised that the entire transaction should take approximately six (6) months and that the (b)(6) Investors" would be out of the investment by then.

On March 25, 2016, ETAK, in a press release indicated that, "Each Unit consists of :(i) one 9% unsecured subordinated convertible promissory note in the principal amount of $30,000..."or "at the option of the holder at a conversion price of $.30 per share, subject to certain exceptions; and (ii) a five-year warrant (each a "Warrant" and collectively, the "Warrants") to purchase one hundred thousand (100,000)shares of Common Stock (the "Warrant Shares") at an exercise price of $.30 per share, subject to certain exceptions. The Company according to its press release sold an aggregate of forty-one (41) Units for $30,000 per Unit.

Furthermore, the Company stated in the press release that, "Additionally, the Company will pay each investor that participated in the Offering an amount equal to ten (10%) of such investors original investment in cash ("the Cash Payment"); provided, however, the Cash Payment will be made if and only if the sale of the

Company's wholly owned subsidiaries, ValidSoft Ltd. and ValidSoft UK Limited is consummated prior to December 31, 2016."Although each of the investors received a note in the amount of thirty-thousand ($30,000) in return for their investment; ETAK, however, failed to pay the agreed ten percent (10%) to each of the (b)(6) nvestor's" original investment of $30,000 in cash. Furthermore, it is our understanding that ETAK failed to register the securities within forty-five (45) days of the final closing as was promised.

Following some positive and negative activity by ETAK including a reorganizationof the Company to Paratèum Corporation (TEUM), the Company finally offered to convert the (b)(6) Investors" notes to shares and warrants as was previously agreed, and each of the (b)(6) Investors" tendered their notes to the Dawson James by January 17, 2017 and awaited the promised securities.

Dawson James in an email dated January 18, 2017 written by (b)(6) (b)(6) verified that they had received the notes on January 17, 2017; and stated that copies of the completed conversion notices were sent to (b)(6) (b)(6) the notes to the Boca Raton office of Dawson James for processing the same day and further transmittal to TEUM.Despite the (b)(6) Investors" tendering their notes and doing all they were required to do on or before January 18, 2017, and notwithstanding Dawson James advising Mr (b)(6) that Dawson James was sending the Notes to for final processing, the (b)(6) nvestors" did not receive any securities until March 6, 2017. In the period between January 18, 2017 and March 6, 2017, the (b)(6) both directly and through their account representative at Dawson James contacted both TEUM and Dawson James on numerous, documented occasions to inquire as to the status of the undelivered securities.

Out of thirty (30) investors, approximately twenty-five (25) similarly situated investors got out of TEUM in a timely fashion by February 2017 and received their profits. Additionally based upon information and belief, some principals and employees of TEUM and Dawson James were also able to sell their holdings and reap their profits, all the while aware of the (b)(6) plight. As of March 6, 2017

when securities were finally sent to the (b)(6) it was too late for them to sell their shares at a profit in the same manner that the other twenty-five (25) investors and other investors, principals and insiders had successfully done previously.

Instead, and contrary to repeated inquiries to Dawson James and TEUM regarding the status of the (b)(6) Investors" expected stock and warrants and their proper tendering of their notes on January 18, 2017, and repeated responses to the (b)(6) from both Dawson James and TEUM during January and February 2017 that the shares had been sent to them, the (b)(6) Investors" did not receive any securities until March 6, 2017, and they received restricted shares of stock which was never agreed to nor requested. (b)(6) Investors" were in no different position than the other twenty-five (25) similarly situated investors who received their proper shares in a timely fashion nor werethey late in tendering their notes. However, either Dawson James or TEUM or both failed to process their requests in a timely fashion, and either or both were untruthful concerning the alleged efforts they were making to comply with the (b)(6) Investors' repeated requests regarding the missing securities. The shares that the (b)(6) Investors" received on March 6, 2017 were valued at $2.65/share and could have been sold on February 27, 2017 for $3.75/share, had the (b)(6) Investors" formal request been processed the in a timely fashion. This would have resulted in a sales price of $41,700.00 each based upon the 11,120 restricted shares they finally received or a group total of $208,500.00, and this is the amount they seek and are justifiably entitled.

What is extremely troubling is that although the Dawson James and TEUM were notified on numerous occasions after January 18, 2017 and before March 6, 2017 that the (b)(6) Investors" had not received the promised securities, indeed the (b)(6) Investors" advised them that the shares had not been received and they were told by both Dawson James and TEUM that they would indeed verify that the shares had been sent to the (b)(6) at the same time as the other similarly situated investors. This is patently untrue.

Obviously, their failure to have the stock tendered in a timely manner as the other similarly situated investors after the January 18, 2017 request

evidences their inexcusable failure to abide by the (b)(6) Investors" request upon their tendering the notes to the Dawson James, and the continual misrepresentations by all other parties involved that the stock was sent.

In early March, 2017, TEUM finally found the (b)(6) Investors'" paperwork which had been buried on a TEUM employees' desk and the restricted stock was belatedly issued as a replacement for the stock which the (b)(6) Investors" were entitled to at the time of their January 18, 2017 formal request.

The (b)(6) Investors" have a well documented and extensive trail of the many efforts to apprise all interested parties and resolve this matter. The (b)(6) are demanding payment of the forsaken profits they were entitled to receive as the other similarly situated investors shortly after making their formal request along with the promised warrants. Thank you for your immediate attention to this matter.

Email from Correspondent:

From: [(b)(6) @yahoo.com]
Sent: 9/29/2017 2:47 PM
To: help@sec.gov
Subject: Re: SEC Response - File (b)(6)

(b)(6)

Isn't TEUM included in the complaint?

According to Dawson James Operations, they forwarded the paperwork to TEUM. Whether they did or not remains to be discovered, but TEUM may be the ultimate culprit here, since our paperwork was allegedly discovered in their possession. Also, their CEO told our account representative they shared part of the blame, but wanted to bear only a part of the claim with Dawson and the transfer agent. Are they included in our complaint?

Also what of the transfer agent are they included in the complaint as well?

Thank you.

Sent from my iPhone

Response to Correspondent:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 9/29/2017 3:56 PM
To (b)(6) @yahoo.com
Subject: Re: SEC Response - (b)(6)

Mr. (b)(6)

Yes, Pareteum is a part of the complaint. Our initial process is to contact the brokerage firm involved. However, upon review of documents, if we find that we need to communicate directly with Pareteum we will do so.

Thanks,
(b)(6)

Email from Correspondent:

From: [(b)(6) @yahoo.com]
Sent: 9/29/2017 4:48 PM
To: help@sec.gov
Subject: Re: SEC Response - File (b)(6)

Thank you

Sent from my iPhone

Emails from Correspondent:

From: (b)(6) (b)(6) [(b)(6) @yahoo.com]
Sent: 10/1/2017 12:20 PM
To: help@sec.gov
Subject: Re: SEC Response - File (b)(6)

(b)(6)

I just want to clarify our complaint a bit.
Even though we properly sent our notes to Dawson James by January 18, 2017, we were the only five investors out of thirty-one in the ETAK offering who did not receive their securities from the company in time to sell in February 2017 for a 42% profit.
We were sent restricted shares on March 6, 2017 instead of unrestricted shares; the shares were not registered within forty-five day as promised in the prospectus; we never received the promised 9% interest also promised in the prospectus.
We do not know who caused the delay: Dawson James, ETAK/TEUM or the transfer agent, but collectively we were harmed financially by them.
Thank you for your cooperation and assistance in this matter.

From: (b)(6) (b)(6) (b)(6) @yahoo.com]
Sent: 10/1/2017 12:51 PM
To: help@sec.gov
Subject: Fw: TEUM/ETAK Documents: Re: SEC Response - File (b)(6)

(b)(6)
This is the acknowledgement From Dawson James that all necessary paperwork to issue the promised securities to us had been received by Dawson James on January 18, 2017.
The Boca reference was to their corporate headquarters in Boca Raton, Florida.
(b)(6) (b)(6) have a similar acknowledgement from Dawson James.
We are at a loss to understand what happened to our notes after they left Dawson James on January 18, 2017.
Our account executive (b)(6) has been most helpful to us, but he is also befuddled as to what occurred here.
He also acknowledges that were have been harmed financially and will assist us in any way he can to help us toward securing a proper remedy.
Thank you for your cooperation and assistance.
----- Forwarded Message -----
From: (b)(6) @dawsonjames.com>
To: (b)(6) (b)(6)
Cc: (b)(6) @dawsonjames.com>
Sent: Wednesday, January 18, 2017 10:45 AM
Subject: RE: TEUM/ETAK Documents

Non Responsive Record

yesterday, I will be sending them down to Boca for processing today. I have attached copies of the completed conversion notices for your records. Feel free to contact me should you have any questions. Best Regards, (b)(6)
(b)(6)

Sales Assistant
Dawson James Securities, Inc.
530 5th Avenue 21st FL
New York, NY 10036 (855) 928-0929 – Toll Free
(b)(6) – (b)(6) – Facsimile
(b)(6) @dawsonjames.com From: (b)(6) (b)(6) (b)(6) yahoo.com]
Sent: Tuesday, January 17, 2017 10:22 AM
To: (b)(6) @dawsonjames.com>; (b)(6) @dawsonjames.com>
Cc: (b)(6) 44@yahoo.com>
Subject: TEUM/ETAK Documents The original notes for (b)(6) were sent to your office on Friday. Delivery was attempted on Saturday. Since the office was closed, delivery is scheduled to occur today. Please be aware that the documents sb arriving today, and please acknowledge your receipt of same. Also, (b)(says his notes are dated in January 2015. I therefore reviewed the others and saw that while (b)(6) notes are dated March 21, 2016, (b)(6) have February 22, 2015 on their notes. Thus, I told (b)(to sign what he was and return them to you. Thank you for your cooperation and assistance.

Exhibit 1

ELEPHANT TALK COMMUNICATIONS CORP
CONVERSION NOTICE

Reference is made to the 9% Unsecured Convertible Promissory Note in the original principal amount of $ 30,000 of Elephant Talk Communications Corp, a Delaware Company (the "Company"), issued to the undersigned (the "Note"). In accordance with and pursuant to the terms of the Note, the undersigned hereby elects to convert the entire outstanding principal amount due and owing under the Note, together with all accrued but unpaid interest thereon, into shares of Common Stock, no par value per share, of the Company (the "Common Stock"), by tendering the original of the Note for cancellation.

Please confirm the following information:

Principal Amount Outstanding under the Note: $30,000

Accrued but unpaid interest under the Note: 27%

Conversion Price: .15

Number of shares of Common Stock to be issued: 279,400

Please issue the Common Stock into which the Note is being converted in the following name and to the following address:

Issue to: (b)(6)

Address:

Facsimile Number:

Authorization: (b)(6)

By:
Title:

Dated: 01/13/2017

(b)(6)

Exhibit I

ELEPHANT TALK COMMUNICATIONS CORP
CONVERSION NOTICE

Reference is made to the 9% Unsecured Convertible Promissory Note in the original principal amount of $ 30,000 of Elephant Talk Communications Corp, a Delaware Company (the "Company"), issued to the undersigned (the "Note"). In accordance with and pursuant to the terms of the Note, the undersigned hereby elects to convert the entire outstanding principal amount due and owing under the Note, together with all accrued but unpaid interest thereon, into shares of Common Stock, no par value per share, of the Company (the "Common Stock"), by tendering the original of the Note for cancellation.

Please confirm the following information:

Principal Amount Outstanding under the Note: $30,000

Accrued but unpaid interest under the Note: 27%

Conversion Price: .15

Number of shares of Common Stock to be issued: 279,400

Please issue the Common Stock into which the Note is being converted in the following name and to the following address:

Issue to: (b)(6)

Address:

Facsimile Number:

Authorization: (b)(6)

Title:

Dated: 1/13/2017

(b)(6)

Exhibit I

ELEPHANT TALK COMMUNICATIONS CORP
CONVERSION NOTICE

Reference is made to the 9% Unsecured Convertible Promissory Note in the original principal amount of $ 30,000 of Elephant Talk Communications Corp, a Delaware Company (the "Company"), issued to the undersigned (the "Note"). In accordance with and pursuant to the terms of the Note, the undersigned hereby elects to convert the entire outstanding principal amount due and owing under the Note, together with all accrued but unpaid interest thereon, into shares of Common Stock, no par value per share, of the Company (the "Common Stock"), by tendering the original of the Note for cancellation.

Please confirm the following information:

Principal Amount Outstanding under the Note: $30,000

Accrued but unpaid interest under the Note: 27%

Conversion Price: .13

Number of shares of Common Stock to be issued: 279,400

Please issue the Common Stock into which the Note is being converted in the following name and to the following address:

Issue to: (b)(6)

Address:

Facsimile Number:

Authorization: (b)(6)

By:

Title:

Dated: 01/13/2017

(b)(6)

Exhibit I

ELEPHANT TALK COMMUNICATIONS CORP
CONVERSION NOTICE

Reference is made to the 9% Unsecured Convertible Promissory Note in the original principal amount of $ 30,000 of Elephant Talk Communications Corp, a Delaware Company (the "Company"), issued to the undersigned (the "Note"). In accordance with and pursuant to the terms of the Note, the undersigned hereby elects to convert the entire outstanding principal amount due and owing under the Note, together with all accrued but unpaid interest thereon, into shares of Common Stock, no par value per share, of the Company (the "Common Stock"), by tendering the original of the Note for cancellation.

Please confirm the following information:

Principal Amount Outstanding
under the Note: $30,000

Accrued but unpaid interest
under the Note: 9%

Conversion Price: .15

Number of shares of Common Stock
to be issued: 229,400

Please issue the Common Stock into which the Note is being converted in the following name and to the following address:

Issue to: (b)(6)

Address:

Facsimile Number:

Authorization: (b)(6)

Dated: 1/13/17

(b)(6)

(b)(6)

Emails to Correspondent:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 10/2/2017 1:05 PM
To: (b)(6) @yahoo.com
Subject: Re: SEC Response - File (b)(6)

Mr. (b)(6)

Thanks for the additional clarification.

Thanks,
(b)(6)

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 10/2/2017 1:11 PM
To: (b)(6) @yahoo.com
Subject: RE: Fw: TEUM/ETAK Documents: Re: SEC Response - File (b)(6)

Mr. (b)(6)

Thanks for providing copies of signed document by (b)(6) to Dawson James Securities.

Thanks,
(b)(6)

Email from Correspondent:

From: (b)(6) @yahoo.com]
Sent: 10/2/2017 10:11 PM
To: help@sec.gov
Subject: Re: SEC Response - File (b)(6)
(b)(6)

This is the link to the March 25, 2016 press release from ETAK announcing the completion of the sales of the unregistered equity securities into which the (b)(6) invested $150,000 (5 X $30,000).
Please note that the company did not register the securities as it promised within 45 days of the final closing.
https://www.sec.gov/Archives/edgar/data/1084384/000114420416090371/v435373_8k.htm

Item 3.02. Unregistered Sales of Equity Securities From February 22, 2016 through March 21, 2016, Elephant Talk Communications Corp. (the "Company") consummated a series of closings (the "Closings") of its private placement offering (the "Offering") of Units (as defined below) to "accredited investors" for aggregate gross proceeds of $1,231,000. The Closings are part of a "best efforts" private placement offering of up to $4,200,000. The Company sold an aggregate of 41 units (the "Units") for $30,000 per Unit at the Closings. Each Unit consists of: (i) one 9% unsecured subordinated convertible promissory note in the principal amount of $30,000 (each a "Note" and collectively the "Notes") which is convertible into shares (the "Note Shares") of common stock of the Company, $.00001 par value (the "Common Stock"), at the option of the holder at a conversion price of $.30 per share, subject to certain exceptions; and (ii) a five-year warrant (each a "Warrant" and collectively, the "Warrants") to purchase one hundred thousand (100,000) shares of Common Stock (the "Warrant Shares") at an exercise price of $.30 per share, subject to certain exceptions. The Company and the Placement Agent (as defined below) agreed to reduce the exercise price of all of the Warrants issued in the Offering from $.45 per share to $.30 per share. Additionally, the Company will pay to each investor that participated in the Offering an amount equal to ten percent (10%) of such investors original investment in cash (the "Cash Payment"); provided, however, the Cash Payment will be made if and only if the sale of the Company's wholly owned subsidiaries, ValidSoft Ltd and ValidSoft UK Limited is consummated prior to December 31, 2016. The Warrants entitle the holders to purchase shares of Common Stock reserved for issuance thereunder for a period of five years from the date of issuance and contain certain anti-dilution rights on terms specified in the Warrants. The Note Shares and Warrant Shares will be subject to full ratchet anti-dilution protection for the first 24 months following the issuance date and weighted average anti-dilution protection for the 12 months period after the first 24 months following the issuance date. The Company is also obligated to file a registration statement registering the Note Shares and Warrant Shares within 45 days of the final closing of the Offering. In connection with the Offering, the Company retained a registered FINRA broker dealer (the "Placement Agent") to act as the placement agent. For acting as the placement agent, the Company agreed to pay the Placement Agent, subject to certain exceptions: (i) a cash fee equal to seven percent (7%) of the aggregate gross proceeds raised by the Placement Agent in the Offering, (ii) a non-accountable expense allowance of up to one percent (1%) of the aggregate gross proceeds raised by the Placement Agent in the Offering, and (iii) at the final Closing one five-year warrant to purchase such number of shares equal to 7% of the shares underlying the Notes sold in this Offering at an exercise price of $.30 and one five-year warrant to purchase such number of shares equal to 7% of the shares underlying the Warrants sold in this Offering at an exercise price of $.45. At the Closings, the Company paid to the Placement Agent an aggregate of approximately $63,229 for its service as placement agent and for other fees and expenses. The Units were offered and sold pursuant to an exemption from registration under Section 4(a)(2) and Regulation D of the Securities Act of 1933, as amended. The foregoing description of the Offering does not purport to be complete and is qualified in its entirety by reference to the Subscription Agreement, the Note and the Warrant, copies of which were filed as Exhibit 10.1, Exhibit 10.2 and Exhibit 4.1 to the Company's Current Report on Form 8-K filed on December 24, 2015.
This is the link to the subscription documents used for the (b)(6) investment in ETAK/TEUM dated December 24, 2015 and filed with the SEC.
EDGAR Filing Documents for (b)(6)

EDGAR Filing Documents for (b)(6)

Thank you for your cooperation and assistance.

Email to Correspondent:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 10/3/2017 7:50 AM
To: (b)(6) @yahoo.com
Subject: Re: SEC Response - File (b)(6)

Mr. (b)(6)

Thanks for the information.

(b)(6)

Email from Entity:

From: (b)(6) @sec.gov]
Sent: 10/17/2017 11:30 AM
To: help@sec.gov
Subject: FW: File (b)(6) - (b)(6) Complaint

From: (b)(6) @dawsonjames.com [mailto (b)(6) @dawsonjames.com]
Sent: Friday, October 13, 2017 11:30 AM
To: (b)(6)
Subject: File (b)(6) (b)(6) Complaint

This message was sent securely using ZixCorp.<http://www.zixcorp.com/get-started/>

Dear Ms. (b)(6)

In connection to your email dated 9/29/2017, please find attached Dawson James' response. As of the date of this communciation, the Firm has not sent a response letter to the client. Please see the attached letter for further explanation. Please let me know if this is sufficient at this time or if you require additional information.

Sincerely,

(b)(6)

This message was secured by ZixCorp<http://www.zixcorp.com>(R).

rcvd 9/18/17

cc: (b)(6)

(b)(6)
Attorney at Law
30 East 33rd Street, 4th Floor
New York, New York 10016
(b)(6)
Fax No (212)889-3197
(b)(6)@gmail.com

(b)(6)

Original

09/28/2017 03:17 15s

September 6, 2017

Mr. (b)(6)
Mr.
Mr.
Mr.
C/o Parateum Corporation
1185 Avenue of the Americas, 37th floor
New York, NY 10036

Mr. (b)(6) (b)(6)
Mr. (b)(6) (b)(6)
C/o Dawson James Securities
1 North Federal Highway, 5th floor
Boca Raton, Fl 33432

Re: Parateum Corporation's (TEUM)
Failure to Pay Funds and to provide warrants Owed to 5 Investors, (b)(6) (b)(6) (b)(6) (b)(6) "the (b)(6) Investors")

My law firm represents the (b)(6) Investors" referred to above.

In the 1st Quarter of 2016 (approximately January, 2016) the above referenced five (5) (b)(6) Investors" each invested thirty-thousand ($30,000) dollars towards the Elephant Talk Communications Corp.'s ("ETAK") private placement offering ("the Offering") of "Units"[1]. The (b)(6) Investors" were advised that the entire transaction should take approximately six (6) months and that the (b)(6) Investors" would be out of the investment by the end of the approximate six (6) month period.

On March 25, 2016, ETAK, in a press release indicated that, "Each Unit

[1] The Company according to its press release sold an aggregate of forty-one (41) Units for $30,000 per Unit.

consists of :(i) one 9% unsecured subordinated convertible promissory note in the principal amount of $30,000..."or "at the option of the holder at a conversion price of $.30 per share, subject to certain exceptions; and (ii) a five-year warrant (each a "Warrant" and collectively, the "Warrants") to purchase one hundred thousand (100,000) shares of Common Stock (the "Warrant Shares") at an exercise price of $.30 per share, subject to certain exceptions."

Furthermore, the Company stated in the press release that, "Additionally, the Company will pay each investor that participated in the Offering an amount equal to ten (10%) percent of such investors original investment in cash ("the Cash Payment"); provided, however, the Cash Payment will be made, if and only if, the sale of the Company's wholly owned subsidiaries, ValidSoft Ltd. and ValidSoft UK Limited was consummated prior to December 31, 2016."

Although each of the investors received a note in the amount of thirty-thousand ($30,000) dollars in return for their investment; ETAK failed to pay the agreed ten percent (10%) to each of the (b)(6) Investor's" original investment of $30,000 in cash. Furthermore, it is also the "the (b)(6) Investors" understanding that ETAK failed to register the securities within forty-five (45) days of the final closing, as was promised.

Following some positive and negative activity by ETAK including a reorganization of the Company to a company called Parateum Corporation (TEUM), the Company finally offered to convert the "(b)(6) Investors" notes to shares and warrants as was previously agreed, and each of the (b)(6) Investors" tendered their notes to Dawson James by January 17, 2017 and awaited the promised securities.

Dawson James in an email dated January 18, 2017 written by (b)(6) (b)(6) verified that Dawson James had received the notes on January 17, 2017; stated that copies of the completed conversion notices were sent to (b)(6) (b)(6) and that (b)(6) (b)(6) was sending the notes to the Boca Raton office of Dawson James for processing the same day, along with transmittal to TEUM.

Despite the "(b)(6) Investors" tendering their notes and doing all they were required to do on or before January 18, 2017, and notwithstanding Dawson James advising Mr. (b)(6) that Dawson James was sending the Notes for final processing, the (b)(6) Investors" did not receive any securities until March 6, 2017. In the period between January 18, 2017 and March 6, 2017, the "(b)(6) Investors" both directly and through their account representative at Dawson James contacted both TEUM and Dawson James on numerous, documented occasions to inquire as to the status of the undelivered securities.

Out of thirty (30) investors, approximately twenty-five (25) similarly situated investors got out of TEUM in a timely fashion by February, 2017 and received their

profits. Additionally based upon information and belief, some principals and employees of TEUM and Dawson James were also able to sell their holdings and reap their profits, all the while aware of the "(b)(6) Investors" plight. As of March 6, 2017 when securities were finally sent to the (b)(6) nvestors", it was too late for them to sell their shares at a profit in the same manner that the other twenty-five (25) investors and other investors, principals and insiders had successfully done previously.

Instead, and contrary to repeated inquiries to Dawson James and TEUM regarding the status of the (b)(6) Investors" expected stock and warrants and their proper tendering of their notes on January 18, 2017, and repeated responses to the "(b)(6) Investors" from both Dawson James and TEUM during January and February 2017, that the shares had been sent to them, the "(b)(6) Investors" did not receive the promised securities until March 6, 2017 along with receiving restricted shares of stock which was never agreed to nor requested.

The "(b)(6) Investors" were in no different position than the other twenty-five (25) similarly situated investors who received their proper shares in a timely fashion nor were they late in tendering their notes. However, either Dawson James or TEUM or both failed to process the "(b)(6) Investors" requests in a timely fashion, and either or both were untruthful concerning the alleged efforts they were making to comply with the "(b)(6) Investors" repeated requests regarding the missing securities.

The shares that the "(b)(6) Investors" received on March 6, 2017 were valued at $2.65/share and could have been sold on February 27, 2017 for $3.75/share, had the "(b)(6) Investors" formal request been processed the in a timely fashion. This would have resulted in a sales price of $41,700.00 each based upon the 11,120 restricted shares they finally received or a group total of $208,500.00; this being the amount they seek and are justifiably entitled to.

What is extremely troubling is that although the Dawson James and TEUM were notified on numerous occasions after January 18, 2017 and before March 6, 2017 that the (b)(6) Investors" had not received the promised securities and although the (b)(6) Investors" advised Dawson James that the shares had not been received, they were advised by both Dawson James and TEUM that they would verify that the shares had been sent to the "(b)(6) Investors" at the same time as the other similarly situated investors. This statement is patently untrue.

Obviously, Dawson James and/or TEUM's failure to have the stock tendered in a timely manner as was the case for the other similarly situated investors after the January 18, 2017 request, evidences their inexcusable failure to abide by the (b)(6) Investors" request upon the "(b)(6) Investors" tendering of the notes to the Dawson James, and the continual misrepresentations by Dawson James and TEUM that the stock was sent.

2017/0 (b)(6)

My clients learned in early March, 2017, that TEUM finally found the (b)(6) Investors'" paperwork which had been buried on a TEUM employees' desk and that the restricted stock was belatedly issued as a replacement for the stock which the (b)(6) Investors" were entitled to at the time of their January 18, 2017 formal request. The (b)(6) Investors" have a well documented and extensive "paper trail" of the many efforts they made to apprise all interested parties of the aforementioned situation and resolve this matter. My clients are demanding payment of the forsaken profits they were entitled to receive (as the other similarly situated investors had received) after making their timely formal request, along with the promised warrants and the remuneration promised to them. My clients do not desire to commence a proceeding against the Company, however, if they do not receive the required remuneration and warrants, etc., that they are entitled to, they will have no other option.

Thank you for your immediate attention to this matter.

Very truly yours,

(b)(6)

(b)(6)

DAWSONJAMES SECURITIES

October 13, 2017

(b)(6)

U.S. Securities and Exchange Commission

RE: File (b)(6)

Dear Ms. (b)(6)

Please note that at this time the Firm has not sent a letter response to the (b)(6) It is important to point out that on September 18, 2017; the Firm received a letter from an attorney representing the (b)(6) investors. The letter (attached) is practically identical to the (b)(6) complaint filed with the SEC. As you will see, the letter was also addressed to principals at the Pareteum Corporation. It is the processing of shares of this corporation, by or at the directive of Pareteum, that are at issue. After receipt of the letter, we communicated with Pareteum and they advised us that they were already aware of the letter/issue and indicated that they were reaching out to the aforementioned attorney in an effort to settle the dispute involving the level of efficiency with which the issuer acted upon the client' instructions. We have subsequently reached out to Pareteum and have been advised that they have indeed been in communication directly with the attorney and are in the process of negotiating a settlement. Based on their assurance to date, we anticipate that Pareteum will satisfy the concerns of the (b)(6) investors shortly.

In connection with Dawson James securities, we have researched the complaint and do not feel that any delay in processing occurred as the result of any mishandling by the Firm or any of our associated persons and will be conveying that to the (b)(6) investors.

Please let me know if you require any additional information at this time. I will be forwarding you a copy of the (b)(6) letter as soon as available.

Sincerely

(b)(6)

(b)(6)

CCO

Email to Entity:

From: (b)(6) @sec.gov]
Sent: 10/17/2017 1:39 PM
To: (b)(6) @dawsonjames.com
Cc: help@sec.gov
Subject: RE: File (b)(6) (b)(6) Complaint

Ms. (b)(6)

The SEC appreciate your providing this information. Our file will remain in open status until we receive a copy of the firm's response sent directly to the (b)(6) family.

Thanks,
(b)(6)

Email from Correspondent:

From: (b)(6) @yahoo.com]
Sent: 10/17/2017 4:32 PM
To: help@sec.gov
Subject: Re: SEC Response - File (b)(6)

Ms. (b)(6)
Has there been any developments on your side with this matter?
I have some had some developments that I would like to discuss with you at your convenience.
I left a message on your answering machine this afternoon.
I will be able to call you tomorrow morning if that suits your schedule.
Please advise of a convenient time.
Thank you for your cooperation and assistance.

Email to Correspondent:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 10/18/2017 9:28 AM
To: (b)(6) @yahoo.com
Subject: Re: SEC Response - File (b)(6)

Good morning Mr. (b)(6)

I just left a voicemail. Please feel free to contact me anytime today. I generally take my lunch at 1:00 - 1:30PM.

Thanks,
(b)(6)

Phone Call – 10/18/2017

Call from Mr. (b)(6) - he received call from Legal and they believe something went wrong but don't believe Dawson James is totally at fault

Email from Correspondent:

From: (b)(6) @yahoo.com]
Sent: 10/25/2017 11:45 AM
To: help@sec.gov
Subject: Re: SEC Response - File (b)(6)

Has there been any response or developments in this matter? I have a trove of information to sustain our case should it become necessary to respond to the other side. Also, my account executive feels positive about this matter as well. Thank you for your cooperation and assistance.

Sent from my iPhone

Response to Correspondent:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 10/26/2017 8:35 AM
To: (b)(6) @yahoo.com
Subject: Re: SEC Response - File (b)(6)

Mr. (b)(6)

The SEC has been advised that Dawson James has full knowledge of the complaint and is in the process of determining its course of handling the complaint.

Thanks,
(b)(6)

Email from Correspondent:

From: (b)(6) @yahoo.com]
Sent: 10/26/2017 8:52 AM
To: help@sec.gov
Subject: Re: SEC Response - File (b)(6)

Thank you. Is There a due date for their response? The company TEUM seems to me to be at fault as well and seems more cooperative to discuss the situation. Thank you again.

Sent from my iPhone

Response to Correspondent:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 10/26/2017 9:17 AM
To: (b)(6) @yahoo.com
Subject: Re: SEC Response - File (b)(6)

As stated in our response, we allow the firm 2-3 weeks to respond to a written complaint. The complaint was sent to Dawson James on 9/29/2017 and a response was expected by October 20, 2017. However, since we have been in communication with the firm, a response is forthcoming.

Thanks,
(b)(6)

Email from Correspondent:

From: (b)(6) @yahoo.com]
Sent: 10/26/2017 9:40 AM
To: help@sec.gov
Subject: Re: SEC Response - File (b)(6)

Thank you

Sent from my iPhone

Email from Correspondent:

From: (b)(6) @yahoo.com]
Sent: 11/1/2017 4:16 PM
To: help@sec.gov
Subject: Re: SEC Response - File (b)(6)

(b)(6)
Has there been any developments or response in this matter from (b)(6) ?
Thank you for your cooperation and assistance.

Email from Correspondent:

From: (b)(6) @yahoo.com]
Sent: 11/1/2017 4:17 PM
To: help@sec.gov
Subject: Re: SEC Response - File (b)(6)

(b)(6)
Has there been any developments or response in this matter from (b)(6) ?
Thank you for your cooperation and assistance.

Phone Call – 11/1/2017

Call to (b)(6) of Dawson Financial (b)(6) He states that Pareteum made an offer to the (b)(6) Attorney but have not heard whether they have accepted. He will check with Legal again and call me back

Phone Call – 11/3/2017

Call from (b)(6) that there's no real update. Pareteum is waiting for (b)(6) attorney to say whether the offer is accepted

Email from Correspondent:

From: (b)(6) @yahoo.com]
Sent: 11/8/2017 3:36 PM
To: help@sec.gov
Subject: Re: SEC Response - File (b)(6)

(b)(6)

Thank you for speaking with me last week and for answering my earlier emails.
You said last week that Dawson James was conferring with Pareteum and the Transfer Agent to fashion a settlement.
Neither my group nor our DJ account executive (b)(6) has heard anything from anyone recently about this alleged settlement.
This matter has been ongoing since January 18th, and it is certainly time for a resolution.
Pleas advise what steps have been taken to remedy the wrong that has been done to us and that all parties agree has occurred.
Thank you again for your cooperation and assistance.

Response to Correspondent:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 11/9/2017 11:47 AM
To: (b)(6) @yahoo.com
Subject: Re: SEC Response - File (b)(6)

Mr. (b)(6)

I was advised by Dawson James that Pareteum has been in communicated with your attorney regarding this matter. Dawson James is under the impression that an offer was presented to your attorney by Pareteum and that Paretuem is waiting to hear from your attorney.

Thanks,
(b)(6)

Emails from Correspondent:

From: (b)(6) @yahoo.com]
Sent: 11/9/2017 4:35 PM
To: help@sec.gov
Subject: Re: SEC Response - File (b)(6);(b)(7)(C)

The Pareteum offer that Dawson James is referring to was made some time ago and is clearly unacceptable, and I thought a new offer might be forthcoming but apparently not as yet.
In his settlement offer, TEUM's attorney alleged that our group could have somehow sold their shares on March 6th for $2.29 per share, and therefore the company should be only responsible for the difference between the February 27 stock price of $3.71 and the March 6th price of $2.29. This is the basis for their settlement offer so far of only this difference.
This is clearly a misstatement of the facts as they really existed. On March 6th the shares were issued by the transfer agent, but our group was not in possession of them until after that date.
The shares as issued on March 6 were also restricted and not unrestricted as the company's attorney alleges, and therefore had to be (a) returned to the company to have the restriction cancelled; (b) had to be returned to the transfer agent to be reissued as unrestricted; (c) had to be delivered to the broker to be offered for sale ; and (d) finally sold in the market. These steps and more are and were time consuming in January when the other similarly situated shareholders to our group were able to sell their shares, and even more so in March.
Even though our group delivered its proper paperwork to Dawson James on January 18th, the restricted shares were not even issued until March 6th, or too late to be sold profitably.
On March 10th the company announced another offering and the subsequent dilution reduced the share price to a closing price of $1.02 by March 22nd. Thus, the aforementioned steps necessary for a subsequent sale would not have been accomplished before then, and a sale for $2.29 of shares not even in our group s possession on March 6th was

therefore impossible.
But for the combined malfeasance by the other parties involved in this transaction, our group could have sold their shares for the $3.71 price that the company's attorney has offered, but without the offset of the irrelevant March 6th pricing.
We just seek to be treated the same as the other similarly situated shareholders, and not be held accountable for the missteps of other parties.
Thank you for your cooperation and assistance.

From: (b)(6) @yahoo.com]
Sent: 11/16/2017 3:37 PM
To: help@sec.gov
Cc: (b)(6) @gmail.com; (b)(6) @yahoo.com
Subject: Fw: Re: SEC Response - File (b)(6)

(b)(6)

Thank you for speaking with me again this morning.
I look forward to hearing from you again, after your conference with your supervisor regarding this matter.
Thank you very much for all your cooperation and assistance on my family's behalf. It is much appreciated.

From: (b)(6) @yahoo.com]
Sent: 11/21/2017 9:09 AM
To: help@sec.gov
Subject: Fwd: SEC Response - File (b)(6)

(b)(6)

I look forward to hearing from you again following your conference with your supervisor concerning this Dawson James/ Pareteum matter.

Thank you again for all your cooperation and assistance on my family's behalf.

Sent from my iPhone

Phone Calls – 11/21/2017:

Call to Mr. (b)(6) - explained that I have not received any update information from Dawson James Financial

Call to (b)(6) for an update on whether Pareteum has decided to settle

Emails from Correspondent:

From (b)(6) @yahoo.com]
Sent: 11/22/2017 11:42 AM
To: help@sec.gov
Subject: Fw: Re: SEC Response - File (b)(6)

(b)(6)

Thank you for speaking with me again yesterday concerning this matter.
As we discussed, the other parties involved all acknowledge that my family has indeed suffered due to their collective fault. However, none of them seems to want to rectify the situation, and blames the others and not themselves.
My Dawson James (DJ) Account Executive, (b)(6) has been in extensive conversations and emails with these parties and has inclusive records of same.
Pareteum admits it made mistakes, but holds DJ and the Transfer Agent also responsible, and wants to share the responsibility between them. DJ does not want to contribute at all to the company's offer despite DJ's allegations, and I do not know the Transfer Agent's position.
Thus, I do not feel any of the parties, including DJ, should be released from this action until an equitable remedy has been found, and my family is properly compensated for all the damages it has suffered.
I do not know who is individually responsible, but I am certain that collectively they have caused my family these damages and harm.
Thank you for all your assistance in this matter on my family's behalf, and enjoy the holiday.
Best regards.

From: (b)(6) @yahoo.com]
Sent: 11/28/2017 11:31 AM
To: help@sec.gov
Subject: Fw: Re: SEC Response - File (b)(6)

(b)(6)

I trust you enjoyed your holiday, and I am just inquiring if there has been any update on my family's predicament.
Thank you for all your cooperation and assistance on their behalf.

Phone Call – 11/29/2017:

Call with (b)(6) (b)(6) that he is still waiting for the Pareteum to settle

From: (b)(6) @yahoo.com]
Sent: 11/30/2017 7:43 PM
To: help@sec.gov
Subject: Fw: Re: SEC Response - File (b)(6)

(b)(6)

Thank you for speaking with me yesterday.
I look forward to hearing further from you concerning any new developments, as they occur.
Thank you again for your cooperation and assistance.

Second Request to Entity:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 12/4/2017 11:59 AM
To: (b)(6) @dawsonjames.com
Subject: FW: Investor Complaint - File (b)(6)

Dear Compliance Officer:

We are writing to follow up on our request for a response to the complaint filed by (b)(6) (b)(6) Please send your response directly to the investor, with a copy to our office, as soon as possible. If you cannot meet this deadline, please let me know. Your response and any other communication regarding the complaint should include the file number noted above.

You may respond to me by email at help@sec.gov, by fax at (202) 772-9293, or by mail at the address shown below. Please be aware that we are unable to access secure web email accounts hosted by regulated entities. If you intend to submit a response to the SEC via encrypted email, please review the SEC External Guide for Using the E-mail Encryption Solution at http://www.sec.gov/about/offices/ocie/secureemailguide.pdf and create an account on our server.

Please note that your response continues to be governed by SEC Form 2405 (www.sec.gov/about/forms/sec2405.pdf).

If you have any questions, please contact (b)(6)

Sincerely,

(b)(6)

Office of Investor Education and Advocacy
U.S. Securities and Exchange Commission
100 F Street, N.E., Washington, DC 20549
(b)(6)
www.sec.gov
www.investor.gov
www.twitter.com/SEC_Investor_Ed

Email from Correspondent:

From: (b)(6) @yahoo.com]
Sent: 12/6/2017 4:11 PM
To: help@sec.gov
Subject: Fwd: SEC Response - File (b)(6)

(b)(6)

My family and I are looking forward to receiving any update you might have.
Thank you again for your cooperation and assistance.

(b)(6)

Sent from my iPhone

Email to Entity:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 12/15/2017 10:46 AM
To: (b)(6) @dawsonjames.com
Subject: RE: FW: File (b)(6) Complaint

Good morning Mr. (b)(6)

This is a follow-up to your October 13, 2017 response to the SEC as well as the many telephone discussions regarding this matter. According to the letter, it is your understanding that Pareteum was in communication with the (b)(6) attorney/family and was in the process of negotiating a settlement.

We understand that the firm do not feel that any delay in processing occurred as the result of any mishandling by the firm or any associated persons. You indicate that the firm will be conveying that to the (b)(6) investors.

After further discussion with my supervisor, the SEC is requesting that Dawson James provide a written response to the (b)(6) family regarding your understanding of this matter. Please copy the SEC on your response to the (b)(6) Family.

Please feel free to contact me directly at (b)(6)

Thanks,
(b)(6)

Phone Call – 12/15/2017

Call from (b)(6)

Response from Entity:

From: (b)(6) @dawsonjames.com]
Sent: 12/18/2017 10:04 AM
To: (b)(6) @sec.gov
Cc: help@sec.gov
Subject: Investor Complaint - File (b)(6)

Dear Ms. (b)(6)

In response to your email request dated 12/15/2017, a copy of the written response sent to the (b)(6) family is attached.

Please let me know if you require any additional information.

Thank you,

(b)(6)

This message was secured by ZixCorp(R).

DAWSONJAMES SECURITIES

December 15, 2017

The (b)(6) Investors
(b)(6)

Re: Dawson James Securities, Inc. ("DJSI") Response to the SEC Complaint File (b)(6)

Dear (b)(6) Investors:

Please accept this letter as Dawson James Securities, Inc.'s ("DJSI" or "Firm") response to the above referenced complaint filed with the U.S. Securities and Exchange Commission ("SEC") and delivered to DJSI on 9/29/2017.

As your filing indicated, DJSI has been aware of your concerns for some time and as such we contemporaneously conducted our own internal review of the timeline associated with the delivery of the securities in question. We have determined that DJSI did not in any way delay the process. As we believe you are aware, the process for the delivery involves other entities such as the Firm's clearing agent, the transfer agent for the Pareteum Corporation and naturally the Pareteum Corporation itself. During our review, we learned that Pareteum themselves made an administrative oversight that added a delay in the processing, a fact they have conveyed to us and, according to Pareteum principals, they have also acknowledged in discussions they have had with the attorney you engaged to assist you with this concern.

Pareteum has indicated to us that they have been attempting to resolve your concern by reaching a settlement. They have also advised that your assessment of the claim for lost opportunity damages does not agree with theirs. It is our understanding that they are wishing to continue this settlement dialogue with you; however, please note that DJSI is not privy to all the elements pertaining to such a settlement.

We wish to once again reiterate that our review revealed that DJSI was not at fault for any unnecessary delay that occurred in the processing of the securities at issue. It is our hope and expectation that you will be able to resolve your concern with the Pareteum Corporation directly.

Sinc(b)(6)
(b)(6)

cc: Securities and Exchange Commission

Email from Correspondent:

From: (b)(6) @yahoo.com]
Sent: 12/18/2017 3:41 PM
To: help@sec.gov
Subject: Pareteum/Elephant Talk

(b)(6)

Now that you are back in your office, has there been any developments in this situation?
Thank you for your cooperation and assistance.
Best regards.

Sent from my iPhone

Response to Correspondent:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 12/19/2017 5:24 PM
To: (b)(6) @yahoo.com
Subject: SEC Response (b)(6)

(b)(6)

Dear Mr. (b)(6)

This is a follow-up to the complaint you submitted to the U.S. Securities and Exchange Commission (SEC) on behalf of the (b)(6) Family.

As you know, the SEC contacted Dawson James Securities regarding the issues you addressed concerning Pareteum (TEUM), formerly Elephant Talk Communications Corp. (ETAK). The SEC has received a response from Dawson James advising that during their review, they learned that Pareteum made an administrative oversight in processing the delivery of the securities in question. Pareteum has indicated that they have been attempting to reach a settlement; however, your assessment of the claim of loss damages differs and both parties have been unable to reach an agreement. We have attached a copy of their response for your convenience.

Please be advised that the SEC is unable to intervene in negotiating of a settlement. We have reviewed your ongoing concerns and our position is that you must seek further counsel in addressing your issues and negotiating a settlement with Pareteum. As a federal regulator, the SEC can only provide general guidance and we cannot advise individuals about the course of action they should follow in their specific circumstances. If you need help finding an attorney, please review the information available at http://www.sec.gov/answers/lawref.htm.

We would also like to inform you that the SEC conducts its investigations on a confidential and nonpublic basis and neither confirms nor denies the existence of an investigation unless the SEC brings charges against someone involved. We do this to protect the integrity and effectiveness of our investigative process and to preserve the privacy of the individuals and entities involved. As a result, we will be unable to confirm whether an investigation exists or of any pending SEC investigation. You may wish to check our website, www.sec.gov, for information about pending SEC civil actions, administrative cases, and other matters.

Please contact me directly at (b)(6) if you have any other questions.

Sincerely,

(b)(6)

Office of Investor Education and Advocacy
U.S. Securities and Exchange Commission
(800) 732-0330
www.sec.gov
www.investor.gov
www.twitter.com/SEC_Investor_Ed
(b)(6)

Response to Correspondent:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 12/19/2017 5:25 PM
To: (b)(6) @yahoo.com
Subject: SEC Response (b)(6)

(b)(6)

Dear Mr. (b)(6)

This is a follow-up to the complaint you submitted to the U.S. Securities and Exchange Commission (SEC) on behalf of the (b)(6) Family.

As you know, the SEC contacted Dawson James Securities regarding the issues you addressed concerning Pareteum (TEUM), formerly Elephant Talk Communications Corp. (ETAK). The SEC has received a response from Dawson James advising that during their review, they learned that Pareteum made an administrative oversight in processing the delivery of the securities in question. Pareteum has indicated that they have been attempting to reach a settlement; however, your assessment of the claim of loss damages differs and both parties have been unable to reach an agreement. We have attached a copy of their response for your convenience.

Please be advised that the SEC is unable to intervene in negotiating of a settlement. We have reviewed your ongoing concerns and our position is that you must seek further counsel in addressing your issues and negotiating a settlement with Pareteum. As a federal regulator, the SEC can only provide general guidance and we cannot advise individuals about the course of action they should follow in their specific circumstances. If you need help finding an attorney, please review the information available at http://www.sec.gov/answers/lawref.htm.

We would also like to inform you that the SEC conducts its investigations on a confidential and nonpublic basis and neither confirms nor denies the existence of an investigation unless the SEC brings charges against someone involved. We do this to protect the integrity and effectiveness of our investigative process and to preserve the privacy of the individuals and entities involved. As a result, we will be unable to confirm whether an investigation exists or of any pending SEC investigation. You may wish to check our website, www.sec.gov, for information about pending SEC civil actions, administrative cases, and other matters.

Please contact me directly at (b)(6) if you have any other questions.

Sincerely,

(b)(6)
Office of Investor Education and Advocacy
U.S. Securities and Exchange Commission
(800) 732-0330
www.sec.gov
www.investor.gov
www.twitter.com/SEC_Investor_Ed
(b)(6)

File (b)(6)

Incoming Complaint:

Correspondent Name: (b)(6)
Create Date: 10/6/2020
Origin: Web
File #: (b)(6)

Send to Entity: Yes

Investor Information
Name: (b)(6)

Address: (b)(6)

(b)(6)

Day Phone (b)(6)
Alt Phone:
Fax:
Email: (b)(6) @gmail.com

Entity Information
Name: AngelMD
Type: Private/Closely Held Company
Representative:
Address: 123 Retiro Way

San Francisco, CALIFORNIA 94123

Security Information
Name: AngelMD
Symbol:
Type: Convertible securities

Description:
Hi,
I have multiple complaints regarding the handling of my investment and general management of the company, not limited to investor relations and I have many supporting documents that I can share with you.
1. The company has not honored the terms of my $75,000 convertible note, made multiple extensions without my approval or sharing documents, and has refused to pay the note when demanded by a majority of note holders.
2. The company has consistently refused to provide Me and other investors with any Performance documents including financials and investor updates for several years, despite multiple attempts to get them through counsel.
3. The company embezzled funds from the company's venture fund for operations and then gave promised the shareholders's carried interest as repayment of the illegal loan.
4. The board has been out of compliance since 2016 with no shareholder board member as required by seed round documents.
5. The company Secretly took A large sum of money provided by investors specifically to manage subsidiary SPVs to pay for operations. This money had been set aside and held in a separate account specifically to manage the SPVs.

5. (b)(6)

The company has refused to provide me my shares with no explanation and also refuses to honor my shareholder's rights to information.

The company has continued to raise money with false or misleading materials. I would like to prevent them from doing so and resolve my conflicts with them.

Best regards,

(b)(6)

Acknowledgement to Correspondent:

From: Help [help@sec.gov]
Sent: 10/6/2020 4:44 PM
To: (b)(6) @gmail.com
Subject: SEC Response

Dear (b)(6)

Thank you for submitting your online contact to the U.S. Securities and Exchange Commission's Office of Investor Education and Advocacy.

In order to ensure that you receive your subscription e-mails and announcements from the SEC, please add us to your contact list, adjust your spam settings, or follow the instructions from your e-mail provider on how to prevent our e-mails from being marked "Spam" or "Junk Mail."

Please do not reply to this message directly.

Thank you,
Office of Investor Education and Advocacy

Response to Correspondent:

From: "Help" <help@sec.gov> [help@sec.gov]
Sent: 10/9/2020 2:48 PM
To: (b)(6) @gmail.com
Subject: SEC Response (b)(6)

Dear (b)(6)

Thank you for contacting the U.S. Securities and Exchange Commission (SEC).

We appreciate the opportunity to review your concerns regarding AngelMD. The SEC's Office of Investor Education and Advocacy processes many comments from individual investors and others. We keep records of the correspondence we receive in a searchable database that SEC staff may make use of in inspections, examinations, and investigations. In addition, some of the correspondence we receive is referred to other SEC offices and divisions for their review. If they have any questions or wish to respond directly to your comments, they will contact you.

Once again, thank you for expressing your concerns.

Sincerely,

(b)(6)

Office of Investor Education and Advocacy
U.S. Securities and Exchange Commission
www.sec.gov
www.investor.gov
www.twitter.com/SEC_Investor_Ed

****

File Attachment:
Correspondent Name: (b)(6)
Create Date: 2020-10-06 20:44:39
Origin: Web
File #: (b)(6)
Description:
Hi, I have multiple complaints regarding the handling of my investment and general management of the company, not limited to investor relations and I have many supporting documents that I can share with you. 1. The company has not honored the terms of my $75,000 convertible note, made multiple extensions without my approval or sharing documents, and has refused to pay the note when demanded by a majority of note holders. 2. The company has consistently refused to provide Me and other investors with any Performance documents including financials and investor updates for several years, despite multiple attempts to get them through counsel. 3. The company embezzled funds from the company's venture fund for operations and then gave promised the shareholders's carried interest as repayment of the illegal loan. 4. The board has been out of compliance since 2016 with no shareholder board member as required by seed round documents. 5. The company Secretly took A large sum of money provided by investors specifically to manage subsidiary SPVs to pay for operations. This money had been set aside and held in a separate account specifically to manage the SPVs. 5 (b)(6) (b)(6) The company has refused to provide me my shares with no explanation and also refuses to honor my shareholder's rights to information. The company has continued to raise money with false or misleading materials. I would like to prevent them from doing so and resolve my conflicts with them. Best regards, (b)(6)
(b)(6)

Exhibit E

GIBSON DUNN

Gibson, Dunn & Crutcher LLP

1050 Connecticut Avenue, N.W.
Washington, DC 20036-5306
Tel 202.955.8500
www.gibsondunn.com

Helgi C. Walker
Direct: +1 202.887.3599
Fax: +1 202.530.9595
HWalker@gibsondunn.com

September 22, 2020

VIA ELECTRONIC MAIL

Office of FOIA Services
U.S. Securities and Exchange Commission
100 F Street, NE
Mail Stop 2465
Washington, D.C. 20549

Re: Freedom of Information Act Request

Dear Sir or Madam:

This is a request pursuant to the Freedom of Information Act. Pursuant to this authority, I request that copies of the following records be provided to me:

1. Any and all records, documents, recordings, communications, analyses, reports and other information from 2017 to the present relating in whole or in part to the impact on convertible debt lenders,[1] microcap[2] issuers, or the microcap industry of requiring convertible debt lenders to register as dealers under Section 15(a) of the Securities Exchange Act of 1934 (15 U.S.C. § 78o(a)) and/or the impact on convertible debt lenders, microcap issuers, or the microcap industry of treating or defining convertible debt lenders as dealers under Section 3(a)(5) of the Securities Exchange Act of 1934 (15 U.S.C. §78c(a)(5)).

We agree to pay the reasonable costs and fees associated with this request. Please deliver the requested records to me at:

Helgi C. Walker, Esq.
Gibson, Dunn & Crutcher LLP

[1] Convertible debt lenders are individuals or entities that provide a loan to a borrower where, pursuant to a convertible promissory note, the borrower may repay the principal by a certain date or, if the borrower does not repay the principal by that date, the lender may elect to have the outstanding loan amount converted into shares of stock in the borrower that are transferred to the lender in lieu of repayment of the principal.

[2] The terms "small-cap" and "penny stock" should be treated as equivalent to "microcap" for purposes of responding to this FOIA request.

1050 Connecticut Ave., N.W.
Washington, DC 20036

Under the FOIA Improvement Act of 2016, agencies must adopt a presumption of disclosure, withholding information "only if . . . disclosure would harm an interest protected by an exemption" or "disclosure is prohibited by law."[3] In accordance with the Office of FOIA Services' legal obligations under the Freedom of Information Act, if you choose to deny this request in whole or in part, please respond in writing and state the statutory exception authorizing the withholding of all or part of the public record and the name and title or position of the person responsible for the denial. Additionally, if it is your position that any portion of the requested records is exempt from disclosure, we request that you provide an index of those documents as required under *Vaughn v. Rosen*, 484 F.2d 820 (D.C. Cir. 1973). As you are aware, a Vaughn index must describe each document claimed as exempt with sufficient specificity "to permit a reasoned judgment as to whether the material is actually exempt under FOIA."[4] Moreover, the Vaughn index "must describe each document or portion thereof withheld, and for each withholding it must discuss the consequences of disclosing the sought-after information."[5] Further, "the withholding agency must supply 'a relatively detailed justification, specifically identifying the reasons why a particular exemption is relevant and correlating those claims with the particular part of a withheld document to which they apply.'"[6]

In the event only some portions of the requested records are properly exempt from disclosure, please disclose any reasonably segregable non-exempt portions of the requested records. If it is your position that a document contains non-exempt segments, but that those non-exempt segments are so dispersed throughout the document as to make segregation impossible, please state what portion of the document is non-exempt, and how the material is dispersed throughout the document.[7] Claims of non-segregability must be made with the same degree of detail as required for claims of exemptions in a Vaughn index. If disclosure of certain requested records is denied in whole, please state specifically that it is not reasonable to segregate portions of such records for release.

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[3] FOIA Improvement Act of 2016 § 2 (Pub. L. No. 114–185).

[4] *Founding Church of Scientology v. Bell*, 603 F.2d 945, 949 (D.C. Cir. 1979).

[5] *King v. U.S. Dep't of Justice*, 830 F.2d 210, 223-24 (D.C. Cir. 1987).

[6] *Id.* at 224 (citing *Mead Data Central, Inc. v. U.S. Dep't of the Air Force*, 566 F.2d 242, 251 (D.C. Cir. 1977)).

[7] *Mead Data Central*, 566 F.2d at 261.

Thank you for your prompt response to this request. We look forward to your determination of this request within twenty business days.[8] If you have any questions, please contact me at HWalker@gibsondunn.com or by phone at 202.887.3599.

Respectfully,

/s/ Helgi C. Walker

Helgi C. Walker

[8] 5 U.S.C. § 552(a)(6)(A).