No. 10-3546

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellee,

v.

SIERRA BROKERAGE SERVICES, INC, *ET AL*.,
Defendants,

and

AARON TSAI,
Defendant-Appellant.

On Appeal from the United States District Court
Southern District of Ohio

CORRECTED BRIEF OF THE
SECURITIES AND EXCHANGE COMMISSION,
APPELLEE

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MISCELLANEOUS

PRELIMINARY STATEMENT

This civil law enforcement action brought by the Securities and Exchange Commission arises from the sale of securities to the public in an unregistered distribution in violation of the registration requirements of Section 5 of the Securities Act, 15 U.S.C. 77e. The familiar but illegal method used by defendant-appellant Aaron Tsai in this case to convert a privately-held business into a publicly-held company without registration is well known to the Commission and the courts. A shell company (a company with no assets or business), which purports to have shares that may be traded publicly, engages in a merger, acquiring a private company that seeks to become a publicly-held company without registration. The Commission and the courts have concluded that participants in such activities have been liable for violating Section 5.

The district court in this case properly found that Tsai, who created and controlled more than 100 shell companies as well as MAS Capital (a broker-dealer), violated Section 5 when he used one of the shell companies he controlled to effect a merger with a privately-held company, and transferred shares ostensibly owned by the shell company's shareholders – but whom Tsai likewise controlled – to people who immediately sold those shares in the public market in unregistered transactions.

Just as the Commission and the courts are no stranger to activities designed to avoid registration in this manner, so too is Tsai, thus warranting relief against him in this case, including an injunction against further violations of Section 5. Tsai has already consented to a Section 5 injunction in a prior case involving one of his other shell companies. *See*

SEC v. Surgilight Inc., SEC Litig.Rel.No. 19169, 2005 WL 770873 (Apr. 6, 2005) (M.D.Fla. No. 6:02-CV-431).

And as Judge Easterbrook recently noted, in a breach-of-contract case brought by Tsai involving another shell company, Tsai has a "large stable" of shell companies that he uses to provide "services designed to evade the requirements that the Securities Act of 1933 imposes on companies that go public." *MAS Capital, Inc. v. Biodelivery Sciences Intern., Inc.*, 524 F.3d 831 (7th Cir.2008). Judge Easterbrook, writing for the Seventh Circuit panel, explained Tsai's *modus operandi* as follows:

> [MAS Capital] incorporated a shell company, MAS Acquisition XXIII, that it represented had tradeable securities; then it arranged for Biodelivery to merge with MAS Acquisition XXIII, which changed its name to Biodelivery Sciences International. Voilà! Stock in Biodelivery now can be bought and sold by the general public. No muss, no fuss, no registration statements, no prospectuses, no waiting periods-none of the expense, delay, and disclosure required by the securities laws. The SEC takes the position that this two-step, known as going public by the back door, which sounds too good to be true, is not lawful. It has commenced several administrative proceedings against MAS Capital and Aaron Tsai, its president and sole director. (Perhaps this is why Tsai has left the country.)

Id. at 833-34. The Seventh Circuit concluded that "Tsai and his corporations take the law, and their promises, entirely too lightly," and the court determined to "send copies of [its] opinion to NASDAQ and the SEC so that they may judge for themselves, in their ongoing administrative proceedings, whether Tsai's promises are credible." *Id.*

COUNTERSTATEMENT OF THE ISSUES

1. Whether the district court properly granted summary judgment in favor of the Commission on its Section 5 registration claim against appellant, where appellant was a direct or indirect participant in the public sale of a company's unregistered securities that did not qualify for the Rule 144(k) safe harbor for satisfying the Section 4(1) exemption from registration, because the company and its shareholders were under appellant's common control, and shares of the company were acquired from these shareholders and resold almost immediately to the public without registration.

2. Whether there was an impermissible variance between the complaint and summary judgment, where the complaint pled a non-fraud-based Section 5 claim and the district court granted summary judgment on that claim.

3. Whether the district court properly granted summary judgment in favor of the Commission on its claims that appellant violated the shareholder reporting provisions of the Exchange Act and related rules, where appellant was the beneficial owner of shares ostensibly held by other shareholders, and appellant failed to report his beneficial ownership of these shares.

4. Whether the district court acted within its discretion in ordering disgorgement of appellant's unlawful gains, and in ordering injunctive relief where appellant has numerous opportunities for future violations and has been previously enjoined from committing violations.

COUNTERSTATEMENT OF THE CASE

A. NATURE OF THE CASE

This Commission action arises from the distribution of securities to the public in unregistered transactions in violation of Section 5 of the Securities Act. The district court granted summary judgment for the Commission, concluding that defendants, including Tsai, violated Sections 5(a) and (c) of the Securities Act by offering and selling unregistered stock to the public. The court also concluded that Tsai violated the shareholder reporting provisions of Section 13(d), 15 U.S.C. 78m(d), and Section 16(a), 15 U.S.C. 78p(a), of the Exchange Act, and Rule 13d-1(a), 17 C.F.R. 240.13d-1(a), and Rule 16a-3, 17 C.F.R. 240.16a-3, thereunder, when he failed to disclose his beneficial ownership of securities. The district court enjoined Tsai from committing further violations, and ordered him to disgorge $250,000 in illegally-obtained profits, plus prejudgment interest.

B. STATUTORY AND REGULATORY SCHEME

1. Section 5 of the Securities Act

The registration provisions of the Securities Act contemplate that the offer and sale of securities to the public must be accompanied by the "full and fair disclosure" afforded by registration with the Commission and delivery of a statutory prospectus containing information necessary to enable prospective purchasers to make an informed investment decision. *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953). Registration entails disclosure of detailed information bearing on the value of publicly-traded securities, including the issuer's financial condition, investment risks, the

identity and background of management, and the price and amount of securities to be offered. *See* 15 U.S.C. 77g and 77aa; *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1098 (2d Cir.1972). The registration statement is "central to the Act's comprehensive scheme for protecting public investors." *SEC v. Aaron*, 605 F.2d 612, 618 (2d Cir.1979), *vacated on other grounds*, 446 U.S. 680 (1980).

To establish a *prima facie* violation of Section 5, the Commission must show that the securities were offered or sold in unregistered transactions and that the mails or interstate means were used in the offer or sale. *See* 15 U.S.C. 77e(a) & (c); *Swenson v. Engelstad*, 626 F.2d 421, 424 (5th Cir.1980). The Commission need not prove scienter, *i.e.*, an intent to deceive. *See SEC v. Universal Major Industries Corp.*, 546 F.2d 1044, 1047 (2d Cir.1976).

The burden then shifts to the defendant to prove that the offer and sale transactions were exempt from the registration requirements. *Ralston Purina.*, 346 U.S. at 126; *SEC v. Cavanagh*, 155 F.3d at 133 (2d Cir.1998). "Registration exemptions are construed strictly to promote full disclosure of information for the protection of the investing public." *SEC v. Cavanagh*, 445 F.3d 105, 115 (2d Cir.2006); *see also SEC v. Kern*, 425 F.3d 143, 153 (2d Cir.2005).

2. The Section 4(1) exemption from registration

Section 5, by its terms, is all embracing; it prohibits the offer or sale of unregistered securities. Through exemptive provisions, however, Congress distinguished between (1) non-exempt *distributions* of securities to the public by the issuer of the securities or from persons in a control relationship with the issuer, which violate Section 5, and (2) exempt *trading*

transactions in the market between investors. *See SEC v. Chinese Consol. Benev. Ass'n*, 120 F.2d 738, 741 (2d Cir.1941).

In drawing this distinction between distributions and trading, Congress not only required registration where securities are sold to the public by the issuer, but all when an intermediary, or "underwriter," has bought the security from the issuer or control person with a view to public resale, or where an intermediary sells for the issuer or control person. Intermediaries' transactions were covered in order to require registration where distributions originate from control persons, and to prevent evasion of the registration requirements by the use of intermediaries. *See Berckeley Inv. Group, Ltd. v. Colkitt*, 455 F.3d 195, 214 (3d Cir.2006); *Chinese Consol.*, 120 F.2d at 741.

In order to require registration for public distributions of securities by the issuer, its control persons and intermediaries, and at the same time exempt trading transactions, Congress exempted from the registration provisions "transactions by any person other than an issuer, underwriter or dealer," Section 4(1), and "transactions by an issuer not involving any public offering," Section 4(2). 15 U.S.C. 77d(1), (2). These provisions exempt transactions, not persons. Thus, for example, if any person involved in a transaction is an "underwriter," *none* of the persons involved may claim exemption for the transaction under Section 4(1). *See Kern*, 425 F.3d at 152; *Zacharias v. SEC*, 569 F.3d 458, 463 (D.C. Cir.2009).

"Underwriter," as defined in Section 2(a)(11), was the statutory device by which Congress subjected the control persons' and

intermediaries' transactions to registration. Section 2(a)(11) broadly defines "underwriter" to mean:

> any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking * * *. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

15 U.S.C. 77b(a)(11).

A "distribution" as that term is used in Section 2(a)(11) is a public offering of securities. *Gilligan, Will & Co. v. SEC*, 267 F.2d 461 (2d Cir.1959). It refers "to the entire process in a public offering through which a block of securities is disbursed and ultimately comes to rest in the hand of the investing public." *Geiger v. SEC*, 363 F.3d 481, 487 (D.C. Cir.2004).

3. Commission Rule 144(k)

During the relevant period in this case, Commission Rule 144(k), the exemption provision relied on by Tsai in this appeal, provided a safe harbor for satisfying the Section 4(1) exemption. *See* 17 C.F.R. 230.144(k). The Commission adopted Rule 144 to provide greater certainty for persons who acquire "restricted securities" (securities that have never been publicly sold) from the issuer or from control persons (referred to as "affiliates" in the Rule) and later seek to resell those securities in public transactions without registration. Such persons, in the absence of a safe harbor, may be seen as acquiring securities "with a view to distribution," and thus be

considered underwriters when they seek to resell. A person satisfying all conditions of the Rule 144(k) safe harbor was deemed not to be engaged in a distribution of the securities and therefore not an underwriter of the securities for purposes of Section 2(a)(11). *See* 17 C.F.R. 230.144 (Preliminary Note). Rule 144 was designed to be a means of satisfying the Section 4(1) exemption, but not the exclusive means. *See* Rule 144(j).[1]

For a sale of restricted securities to satisfy Rule 144(k), a seller had to meet two conditions. *Kern*, 425 F.3d at 148-49. First, the person selling the restricted securities could not have been an affiliate of the issuer at the time of the sale, and during the preceding three months. Second, at least two years must have elapsed since the securities were last acquired from an issuer or affiliate of the issuer. Only this second condition is at issue in this appeal.[2]

If a defendant asserting a Rule 144(k) exemption failed to demonstrate *either* of these requirements, he was not entitled to claim the safe harbor in Section 144(k). Conversely, if both conditions of Rule 144(k) were met, a seller who acquired stock from an affiliate or issuer could sell

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[1] Rule 144(k) has since been removed, and the conditions that non-affiliates are required to meet for the sale of their securities under Rule 144 are now in Rule 144(b).

[2] Rule 144(k) applied to sales of securities:

> sold for the account of a person who is not an affiliate of the issuer at the time of the sale and has not been an affiliate during the preceding three months, provided a period of at least two years has elapsed since the later of the date the securities were acquired from the issuer or from an affiliate of the issuer.

17 C.F.R. 230.144(k).

his stock in reliance on the safe harbor and not be deemed an underwriter. *See* 17 C.F.R. 230.144(k) & Preliminary Note; *Kern*, 425 F.3d at 148-49.

In Rule 144 the term "affiliate," which refers to a control person, is described, in language almost identical to that in Section 2(a)(11), as a person that "directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer." 17 C.F.R. 230.144(a)(1); *Kern*, 425 F.3d at 148-49. While Rule 144 does not define "control," Rule 405 of Regulation C (containing an identical definition of "affiliate"), defines "control" as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person whether through the ownership of voting securities, by contract, or otherwise." 17 C.F.R. 230.405; *see also Kern*, 425 F.3d at 149 (applying definition of "control" under Rule 405 to define "control" under Rule 144(k)).

C. DEFENDANTS

1. Aaron Tsai

Appellant Tsai was the chairman, president, chief executive officer, treasurer, and controlling shareholder of shell company MAS Acquisition XI Corporation ("MAS") from the time of its incorporation until a merger in which it acquired Bluepoint Linux Software Company ("Bluepoint"). Dkt.125, Exh.3 ("Tsai.2002") 23:3-12; Dkt.117, Exh.A ("Tsai.Decl.") ¶7. Tsai also controls MAS Capital Securities, Inc., a broker-dealer. Tsai.2002 10:6-11:2.

2. Promoters

The several defendants who acquired MAS's shares and sold them less than a month later to the public are collectively referred to as the "promoters." The promoters are: Michael M. Markow, Global Guarantee Corporation (controlled by Markow), Yongzhi Yang, K & J Consulting, Ltd. (controlled by Yang), Ke Luo, M&M Management, Ltd. (controlled by Luo), and Francois Goelo.

3. Other Defendants

The other defendants, who were involved in making sales to the public, are: Sierra Brokerage Services, Inc., Jeffrey A. Richardson (Sierra's president and head trader), Richard Geiger (representative and trader at Sierra), and Jerome B. Armstrong.

D. FACTS

1. Tsai forms MAS – one of Tsai's 101 shell companies – in order to issue shares that would purportedly become publicly tradeable, and then he effects a reverse merger with a private company seeking to go public.

From 1996 through 2000, Tsai formed 101 shell companies. Dkt.121, ("Tsai.2004") 25:8-26:9; Dkt.125, Exh.2 at 6-8. This case concerns MAS Acquisition XI Corporation, formed on October 7, 1996 – shell company number eleven in Tsai's MAS Acquisition line of shell companies. Dkt.125, Exh.21 ("Form 10-SB") at 26; Tsai.2004 47:9-48:6, 49:2-6. Like Tsai's other shell companies, MAS had no business operations, revenue, or earnings, and was formed for the "sole purpose" of issuing purported publicly-trading shares, thereby making MAS "an attractive candidate for a prospective merger with a private company desiring to go public," a so-

called reverse merger. Tsai.Decl. ¶¶5-6, 8-9, 11 (MAS "shares were essentially worthless unless and until a merger ultimately took place"); *see also* Tsai.2004 26:13-27:10; Tsai.2002 30:19-22.[3]

2. Tsai transfers shares to five purported "directors," but these individuals never performed any services as directors, never attended shareholder meetings, did not receive stock certificates, and gave Tsai blank stock powers.

After forming MAS and issuing 8.5 million shares of MAS's common stock to himself, Tsai then issued 1,250 of MAS's common stock shares – 500 on January 1, 1997, and 750 on September 30, 1998 – to five individuals. Tsai reported in SEC filings (a Form 10-SB filed by MAS) that these shares were issued "to former directors of [MAS] as compensation for their services." Form 10-SB at 26; Dkt.125, Exh.22 ("Form 10-SB/A") at 27; Tsai.2004 47:9-48:6, 49:2-6.[4] On January 1, 1997, Tsai also transferred 50,000 of his shares to each of these five purported directors. Form 10-SB/A at 27.

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[3] In a "reverse merger" a private company is acquired by a publicly-held, or purportedly publicly-held, shell company. The shell company has minimal assets and no operations, but has publicly-trading shares. The shell company exchanges its stock for the private company's assets. After a reverse merger, the new company assumes the corporate identity, management, and name of the former private company. Thus, in a reverse merger, it is intended that a private corporation be transformed into a publicly-traded company. *See Cavanagh*, 445 F.3d at 108n.4; *SEC v. M & A West, Inc.*, 538 F.3d 1043, 1046 (9th Cir.2008).

[4] A Form 10-SB, required to register a class of securities of a small business under the Exchange Act, may be voluntarily filed. *See* 15 U.S.C. 78l(g), 17 C.F.R. 240.12b-2. Tsai prepared and voluntarily filed MAS's Form 10-SB on April 16, 1999, and an amended Form 10-SB on June 22, 1999. Tsai.2002 24:1-17.

Tsai made these and later transfers of MAS shares "to increase the number of shareholders," in an effort to make MAS's shares publicly traded. Tsai.Decl. ¶9.

Although, as noted, MAS reported in Commission filings that these five individuals received shares as "compensation" for their services as "directors," none of them performed any services for MAS (Tsai.2004 92:12-17), and Tsai has since called them "honorary directors" (Br.55, Tsai.Decl. ¶16), or "five of his friends" (Br.29, Tsai.Decl. ¶9). Tsai concedes that MAS's filings with the Commission contained this and the following other inaccuracies: [5]

- Although MAS reported that its board of directors "consists of three members," (Form 10-SB/A at 44 ¶3.02), Tsai admitted that this statement was "inaccurate" because he was the only director. Tsai.2004 51:11-52:18.
- Although MAS reported that annual shareholder meetings were required to be held, and directors elected at these meetings (Form 10-SB/A at 41 ¶2.02), Tsai held these meetings and elected directors by himself. Tsai.2004 181:4-182:9.
- Although MAS reported that notice of shareholder meetings "shall be delivered" to shareholders (Form 10-SB/A at 41-43 ¶¶2.04, 2.10), Tsai could not recall ever providing such notice. Tsai.2004 182:10-184:15.
- Although MAS reported that stock certificates "shall be delivered" to MAS's shareholders (Form 10-SB/A at 51-52 ¶7.01), they were not in fact delivered. Tsai.2004 65:8-66:13.

[5] These filings are not the basis of Tsai's reporting violations, *see* Argument III.

In addition, Tsai had these five individuals sign blank stock powers when they became shareholders.[6] Tsai.2004 43:20-44:15; *e.g.*, Dkt.101 (Hemmer) 19:12-21:13 & Exh.2; Dkt.114 ("Lee") 29:7-31:6 & Exh.27. Here, the stock powers were blank forms that did not contain the name of the transferee or the number of shares involved. *Id*. Tsai "had them sign," and he could later "go back to type in the information." Tsai.2002 159:18-24. Tsai explained that these blank stock powers enabled him to transfer, at will, the stock issued in the names of these individuals. Tsai.2004 41:7-42:8.[7]

3. Tsai transfers shares from the five individuals to an additional 28 people, in an effort to expand the number of MAS's shareholders.

From July through December 1999, Tsai endeavored to get the stock held by the five purported directors cleared for public trading by the NASD. Tsai.Decl. ¶9. To that end, on July 14, 1999 a broker-dealer firm retained by Tsai, Kensington Capital Corporation, filed a Form 211 with the

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[6] A "stock power" is "a power of attorney permitting a person, other than the owner, to transfer ownership of a security to a third party." *Black's Law Dictionary* (8th ed.2004).

[7] One of the five individuals to whom Tsai initially transferred shares included a mentally-disabled shareholder referred to as "April C." Tsai.Decl. at 4 ¶9; Dkt.125, Exh.28; Dkt.125, Exh.23 (Hawkins) at 9:2-10:10, 22:1-18, 24:1-20. As her caretaker testified, April C. would not be able to understand what a corporate director is, what shares of stock are worth, what legal documents mean, and April C.'s limitations would be obvious to anyone interacting with her. Hawkins 33:24-35:24; Dkt.125, Exh.27 at 47 (April C. stock power).

NASD. Dkt.125, Exh.25 (Form 211, July 1999).[8] On July 26, 1999, the NASD rejected the Form 211 as "deficient," because the proposed tradeable shares of MAS were "being held by 5 shareholders" – the purported directors – which was an unacceptably high "concentration" of holdings. Dkt.125, Exh.26 (NASD rejection letter).

In response to the NASD's rejection of the Form 211, Tsai "found more shareholders" by transferring shares he had provided to the five purported directors to 28 additional shareholders. Tsai.2004 104:24-105:22; Tsai.Decl. ¶9 ("I arranged for the transfer of most of [the five individuals'] shares to 28 additional friends, acquaintances or associates."). The purpose of Tsai's transfers was to reduce the concentration of shares by spreading them among a total of 33 individuals, thereby allaying the NASD's concerns, and advancing his goal of making MAS an attractive merger candidate with publicly-trading shares. Tsai.2004 110:11-17, 111:3-14.

Tsai transferred these shares using the blank stock powers that he previously had the five purported directors sign, and Tsai chose *which* of

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[8] Pursuant to NASD Rule 6740, before a broker-dealer firm quotes a security on the Over-the-Counter ("OTC") Bulletin Board, it submits a Form 211 to the NASD to demonstrate satisfaction of Commission Rule 15c2-11, 17 C.F.R. 240.15c2-11 (directing a broker-dealer to maintain in its files current information about the issuer). Dkt.129 ("McClarin") 33:3-5. As part of the Form 211 application, it is not uncommon for broker-dealers to submit an attorney letter opining, based on information provided by the issuer, that the shares are available for quotation, but confirming that quotation is not being solicited by issuers or control persons. According to the NASD files in this case, it received an unsigned attorney opinion to that effect (Dkt.125, Exh.28 at 179-80), and the attorney whose name appears later denied authorizing its transmittal to the NASD (Dkt.145 at 4).

the five shareholders would make a transfer to a particular transferee, and the *amount* of shares to transfer, on a "more or less arbitrary" basis. Tsai.2004 108:8-110:6; *see also id.* 112:10-20, 41:7-44:15; Tsai.2002 159:18-24; Dkt.101 at Exh.2; Dkt.125, Exh. 28. Tsai transferred the shares without providing any compensation to the five purported directors. Dkt.125, Exh.28. Tsai also obtained additional blank stock powers from the 28 new shareholders. Tsai.2002 72:10-74:12; Tsai.Decl. ¶15; Dkt.125, Exh.27; Br.7; *e.g.*, Lee 29:7-31:6 ("I signed the stock powers without anything written on it"). Tsai did not issue them stock certificates. Tsai.2004 222:22-223:18, 64:2-17; Tsai.2002 108:2-12.

On September 1, 1999, after these additional transfers were complete, Kensington Capital resubmitted to the NASD the expanded list of 33 MAS shareholders. Dkt.125, Exh.28 at 178; Tsai.Decl. ¶9. On December 13, 1999, the NASD approved MAS's Form 211, and cleared these MAS shares for public trading on the OTC Bulletin Board. Dkt.125, Exh.29. Tsai testified that after the Form 211 process was completed, these shares became more liquid, and therefore more valuable. Tsai.2004 228:3-20. Although the Form 211 process was designed to allow shareholders to sell shares in the public market (this is what Tsai intended when he sought to make MAS shares "tradeable"), Tsai conceded that neither the five purported directors nor the 28 additional shareholders knew that the Form 211 process had been completed. Tsai.2004 227:20-228:2.

4. Tsai signs a reverse merger agreement between MAS and Bluepoint.

Now that Tsai's shell company had shares cleared for public trading, it was time to find a private company that wanted to become public. Markow, one of the promoters, contacted Tsai about a merger between MAS and Bluepoint, a Chinese company, formerly known as Shenzhen Sinx Software Technology Corporation, that claimed to have developed a Chinese version of the Linux computer operating system. Dkt.113 (Yang) 42:19-43:5, 51:11-23, 65:13-25; Tsai.2002 at 16:12-15. Between December 1999 and January 2000, Tsai began negotiating with Bluepoint. Tsai.2004 186:25-195; Tsai.2002 16:12-25; Dkt.125, Exh.30.

As a preliminary step to the reverse merger, on January 5, 2000 Tsai cancelled over 8.2 million of the MAS shares that he had issued to himself on MAS's date of incorporation, retaining 453,000 of these shares. Dkt.125, Exh.32 (Form 8-K filed February 18, 2000) at 2; Dkt.125, Exh.1 ("Helpingstine") ¶10. Two days later, on January 7, MAS effected a 15-for-1 stock split. Dkt.125, Exh.32 at 2. As a result of the stock split, the 250,000 shares held in the names of the 33 shareholders (that had been cleared for trading by the NASD) became 3.75 million shares. *Id.*

On the same day as the stock split, Tsai signed, as president of MAS, a reverse merger agreement between MAS and Bluepoint. Dkt.125, Exh.30 (Agreement); Tsai.2004 196:2-18.

5. Tsai transfers the 33 MAS shareholders' shares to the promoters.

At the same time that the reverse merger agreement was signed, the promoters began the process of purchasing from Tsai the purported publicly-tradeable shares held in the names of the 33 MAS shareholders. Tsai.2004 222:13-224:17. On January 7, 2000, the promoters were notified that the purchase price for all of the 33 MAS shareholders' shares was $250,000 (Goelo told Yang, Yang notified Luo). Dkt.125, Exh.33; Dkt.113 at 218:7-19. On January 20 and February 7, 2000, three of the promoters each sent wire transfers to Markow totalling $249,980 (one bank deducted a wire fee). Dkt.125, Exh.34; Dkt.125, Exh.6 ("Markow") 67:3-68:4, 80:21-82:10-25. On February 8, 2000, the day after receiving the last of these wire transfers, Markow sent Tsai a cashier's check for $250,000. Dkt.125, Exh.35.

In return, Tsai for the first time created stock certificates for the 33 shareholders' shares, and mailed Markow the 33 shareholders' stock powers and stock certificates. Tsai.2004 222:22-223:18, 64:2-17; Tsai.2002 108:2-12. The 33 shareholders never saw the stock certificates. *Id*. On February 14, 2000, Markow sent each of the 33 shareholders a check for $100, regardless of whether 15,000 or 135,000 of their shares (the range of the shareholders' holdings) were sold. Dkt.125, Exh.37; Tsai.2004 218:23-220:6; Dkt.125, Exh.28 at 178. Several shareholders testified that they did not know that they had sold their shares. *E.g.*, Dkt.103 31:2-8; Dkt.105 34:1-14, 41:3-4. Tsai understood that the merger agreement made the shares more valuable, yet the 33 shareholders did not know that a merger agreement had been signed. Tsai.2004 227:11-228:20.

The reverse merger was executed on February 17, 2000; MAS acquired Bluepoint, and MAS changed its name to "Bluepoint." Dkt.125, Exh.39; Tsai.2002 143:1-144:15. On February 22, 2000, Markow cancelled all of the 33 shareholders' stock certificates, and new certificates in the promoters' names were issued. Dkt.125, Exh.41; Markow 52:13-53:19.

6. Within weeks of acquiring their shares, the promoters sell them in public transactions to investors who lacked important information about the company.

The promoters touted Bluepoint stock on the internet and through a press release. Dkt.118, Exh.70 (internet postings); Dkt.139, Exh.6; Dkt.125, Exh.55 (press release). Less than a month after the promoters acquired the stock, on March 6, 2000, Bluepoint began publicly trading on the OTC Bulletin Board. Dkt.125, Exh.55. The promoters, who sold Bluepoint stock on the first days of trading, sold their stock for a profit totalling more than $3.8 million. Helpingstine ¶¶19, 28, 36, 44. They were able to do so because on the first day of trading the price of Bluepoint shot up from $6 per share to peak at $21 per share. Dkt.274, Exh. 9. By June 2000, however, Bluepoint was selling at only $3 per share and never rose above $5 per share thereafter. Dkt.275, Exh. 2. Because the promoters' distribution was not registered, and because the post-merger company did not file with the Commission the information that would have been in a registration statement until over one month after the distribution began, investors who purchased Bluepoint during this time were denied the important

information about the new company that would have been included in a registration statement.[9]

E. PROCEDURAL HISTORY

The Commission instituted this action on April 11, 2003, alleging that Tsai and the promoters violated the registration provisions of the Securities Act, and violated the shareholder reporting provisions under the Exchange Act. The complaint also charged the promoters, but not Tsai, with violating the antifraud provisions in Section 17(a) of the Securities Act, 15 U.S.C. 77q(a), and Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5, promulgated thereunder. The Commission sought permanent injunctions against future violations, disgorgement of the proceeds obtained as a result of these violations, and civil monetary penalties. Dkt.1.

Thereafter, the Commission moved for summary judgment against Tsai on the registration and reporting violations, Tsai cross-moved for summary judgment on these claims, and the district court denied Tsai's

[9] Prior to the distribution, Tsai and the promoters – but not investors – reviewed Bluepoint's business plan and financial statements, which contained a detailed description of Bluepoint's product, risks, and financial projections, and showed that Bluepoint did not have any significant revenue. Dkt.125, Exh.31 at 224-226, 228-237; Tsai.2004 188:16-192:24. Bluepoint filed a Form 8-K/A containing financial statements on April 18, 2000.

motion and granted summary judgment in favor of the Commission.[10] The district court concluded that the Commission demonstrated Tsai's *prima facie* violation of Section 5 (Dkt.221 ("Op.") at 26-32); the public sales by the promoters were not exempt under Section 4(1) because the promoters acquired shares from affiliates (the 33 shareholders) that they sold in a public distribution (*i.e.*, were underwriters) (Op.41-47); the safe harbor under Rule 144(k) was unavailable because the promoters sold their shares without holding for two years after they purchased their shares from affiliates of the issuer (Op.33-41). The district court rejected Tsai's argument that he did not have notice of the non-fraud nature of the Commission's Section 5 claim. Op.47-51. The district court also concluded that Tsai violated the reporting provisions by underreporting his beneficial ownership of MAS shares. Op.53-55.

The district court permanently enjoined Tsai against committing future violations, and ordered him to pay disgorgement and prejudgment interest totaling $351,987. Op.84-85.[11]

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[10] The district court granted summary judgment in favor of the Commission against the other defendants on the Section 5 claims, and denied the promoter defendants' motion for summary judgment on the fraud claims.

[11] The district court reserved the issue whether Tsai should pay civil penalties, and the Commission will move for civil penalties in the event that this Court affirms the district court's March 1, 2009 judgment. Dkt.244. (Judgment was entered under Fed.R.Civ.P. 54(b), giving this Court jurisdiction pursuant to 28 U.S.C. 1291 or 1292(a)(1)). The Commission has also instituted an administrative proceeding against Tsai, based on the violations found in this case. *See In re Aaron Tsai*, No. 3-13835.

SUMMARY OF ARGUMENT

Undisputed facts demonstrate that Tsai controlled MAS and its 33 shareholders who held purportedly tradeable shares. Tsai admits that he controlled MAS, and Tsai likewise controlled its shareholders by using blank stock powers to transfer their shares at will, and by refusing to observe the most basic principles of corporate governance.

As alleged in the complaint and demonstrated on summary judgment, Tsai's control renders him liable for violations of the registration provisions and the shareholder reporting provisions. Because MAS and the 33 shareholders were under Tsai's common control, the promoters acquired their shares from affiliates of the issuer, making Rule 144(k)'s safe harbor for satisfying the Section 4(1) registration exemption unavailable when these shares were immediately resold to the public without registration. Tsai's control over these shares also demonstrates that Tsai was their beneficial owner, which he never disclosed as required by the shareholder reporting provisions. Because Tsai's control of 100 other shell companies makes his future violation of these provisions likely, and Tsai has been previously enjoined, ordering relief here was appropriate.

STANDARD OF REVIEW

This Court reviews a district court's grant or denial of summary judgment *de novo*. *Seaway Food Town, Inc. v. Medical Mutual*, 347 F.3d 610, 616 (6th Cir.2003). Summary judgment is appropriate if "there is no genuine issue as to any material fact." Fed.R.Civ.P. 56(c). Although in reviewing a district court's grant or denial of summary judgment evidence

is viewed "in the light most favorable to the nonmoving party," the evidence offered by the nonmoving party must be "significantly probative." *Macy v. Hopkins*, 484 F.3d 357, 363 (6th Cir.2007). This Court will uphold a grant of summary judgment "where the record as a whole could not lead a rational trier of fact to find for the non-moving party." *Cummings v. Akron*, 418 F.3d 676, 682 (6th Cir.2005).

The district court's order of disgorgement and injunctive relief is reviewed for an abuse of discretion. *SEC v. Youmans*, 729 F.2d 413, 415 (6th Cir.1984).

ARGUMENT

I. TSAI VIOLATED THE REGISTRATION PROVISIONS OF SECTION 5 BY PARTICIPATING IN SECURITIES SALES FOR WHICH NO EXEMPTION WAS AVAILABLE.

Undisputed facts demonstrate that Tsai violated Section 5 because he directly or indirectly participated in the promoters' sales of securities in an unregistered distribution. On appeal, Tsai argues that the promoters' sales were exempt from registration under Rule 144(k), Br.27-47, but he cannot sustain his burden. The promoters' public sales were not exempt because the stock they sold was acquired from affiliates – control persons – of the issuer.[12]

[12] Many of the issues addressed in the district court's comprehensive opinion are not at issue in this appeal. For example, the district court rejected arguments that Tsai's distributions of securities to the 33 shareholders leading up to the reverse merger did not violate Section 5. Op.26-32.

A. Tsai's undisputed control over both MAS and the 33 shareholders shows that the shareholders were under common control with the issuer, and therefore defeats exemption under Section 4(1) and Rule 144(k).

Exemption under both Section 4(1) and Rule 144(k) here depends on whether and when shares were acquired from persons in a control relationship with the issuer. A control person, or affiliate, is any person that directly or indirectly "controls," or is "controlled by," or is under "common control" with, the issuer. 17 C.F.R. 230.144(a)(1). As demonstrated below, Tsai controlled MAS and Tsai also controlled the 33 shareholders. Therefore, MAS and the shareholders were under Tsai's "common control."

When the promoters acquired shares in February 2000 – whether the shares are seen as having been acquired from the 33 shareholders or from Tsai – the promoters acquired from affiliates of the issuer. If the promoters are viewed as having acquired from the shareholders, the promoters acquired from persons under "common control" with the issuer. Alternatively, because of the extent of Tsai's control over MAS and the shareholders, the promoters' February 2000 purchase can also be viewed as a purchase from *Tsai*, who was at all times "controlling" the issuer.

Under either alternative, it cannot be seriously disputed that the promoters acquired these shares with "a view" to their distribution, as specified in the Section 2(a)(11) definition of "underwriter." The promoters purchased the shares in order to profit from a public distribution on the OTC Bulletin Board, and the promoters indeed began selling their shares to the public for enormous profits less than one month later.

Because the promoters acquired the stock in February 2000 from control persons with a view to public distribution, they were "underwriters" when they sold their stock. Because the public sales involved underwriters, and Section 4(1) is unavailable if *any* person involved in a transaction is an underwriter (*Kern*, 425 F.3d at 152, *Zacharias*, 569 F.3d at 463), exemption under 4(1) is also unavailable to Tsai, regardless of whether Tsai himself was an underwriter.

The safe harbor in Rule 144(k) is similarly not available because in February 2000 the promoters acquired securities from affiliates, and sold those shares to the public in March 2000 – far less than two years after this acquisition. *See Cavanagh*, 445 F.3d at 110-13 (affirming summary judgment where sellers "were 'affiliates' of an 'issuer' when the challenged transactions occurred"). This is true whether the promoters are viewed as having acquired from the 33 shareholders or Tsai. Under either view, Tsai cannot satisfy the necessary two-year holding period in Rule 144(k), and accordingly no safe harbor was available. *See Kern*, 425 F.3d at 148-49.

Tsai argues that the safe harbor is satisfied because his transfer of shares to five purported directors on January 1, 1997, and the transfer of shares from the five shareholders to 28 additional shareholders, were "gifts," and therefore that the 33 shareholders held their shares for more than two years prior to the February 2000 sales to the promoters. Br.28-33. Presumably Tsai's argument is an attempt to show that the promoters satisfied the Rule's two-year holding period by tacking their holding period to the shareholders' holding period (which Tsai contends was at

least 34 months). Br.31-33 (discussing Rule 144(d)(3)(v), 17 C.F.R. 230.144(d)(3)(v) (determination of holding period for "gifts")).

However, this argument fails because even if the transfers *between shareholders* were "gifts," no one argues that the shareholders "gifted" their shares *to the promoters* in February 2000. The tacking provision cited by Tsai provides that where there is a gift of securities by an affiliate donor, the donor's holding period can be tacked-on to the donee's holding period. Here, because the shareholders made no gift to the promoters, the shareholders were not donors and the promoters were not donees, and this tacking provision does not apply.

Here, the promoters purchased shares from affiliates, and the *promoters* did not hold the shares for two years before reselling them to the public; therefore it does not matter how long those *affiliates* had held their shares. Rule 144(k)'s two-year holding period by its terms begins to run anew every time restricted securities are purchased from an affiliate. Every purchase from an affiliate restarts the two-year clock, no matter how long the restricted securities had previously been held. *See Resales of Securities*, Release No. 6032 (March 5, 1979).

Furthermore, the undisputed record precludes Tsai's argument that his transfer of shares to the five purported directors was a *bona fide* gift. As we discuss below, Tsai retained such sweeping control over these five shareholders' shares that *Tsai* was able to later "re-gift" these same shares to 28 people, and transfer the shares as he pleased. There was plainly no gift.

B. Tsai's control over MAS and the 33 shareholders cannot be disputed.

As described above, if Tsai controlled MAS and the 33 shareholders, no exemption is available. Tsai concedes that he controlled MAS, but argues that he had only "limited authority" to control the 33 shareholders. Br.33-41. The undisputed record, including Tsai's own testimony and documentary evidence, devastates his argument.

Contrary to Tsai's contentions (Br.36), Congress wanted control to be "broad[ly]" defined (*Kern*, 425 F.3d at 150n.3), based on "the realities of the situation" (*SEC v. Intern'l Chem. Dev. Corp.*, 469 F.2d 20, 28 (10th Cir.1972)). *See also* H.R.Rep.No. 1383, 73d Cong, 2d Sess. 26 (1934) (Congress wanted control broadly defined because it is "difficult if not impossible to enumerate or to anticipate the many ways in which actual control may be exerted"). Accordingly, contrary to Tsai's suggestion (Br.41), courts of appeals are not shy to affirm summary judgment where the undisputed facts demonstrate control. *E.g.*, *Kern*, 425 F.3d at 148-50; *Cavanagh*, 445 F.3d at 111-16; *M & A West,* 538 F.3d at 1051-53.

1. Tsai controlled MAS.

Tsai's control over MAS is beyond dispute. Tsai was MAS's chairman, president, chief executive officer, treasurer, and "controlling shareholder" from the time of its incorporation until its reverse merger with Bluepoint. Tsai.2002 23:3-12; Tsai.Decl. ¶7.

In addition, Tsai's ability to single-handedly execute MAS's reverse merger demonstrates his control over MAS. *See Kern*, 425 F.3d at 148-50;

M & A West, 538 F.3d at 1051n.9 ("The authority to transfer ownership of the company" establishes control); Dkt.125, Exh.30 ¶1.02.[13]

Furthermore, Tsai's failure to observe the corporate formalities required by MAS's bylaws – *e.g.*, he was the only member of MAS's board of directors, and held annual shareholder meetings by himself and without notice – likewise demonstrated Tsai's control over MAS. *See Kern*, 425 F.3d at 149.

Tsai distinguishes *Kern*, arguing that the control persons in that case had transferred shares to their friends, and then "reacquired" a 90% stake from these friends, whereas he did not "reacquire" stock from the shareholders. Br.34-37. This is a pointless distinction in light of the fact that Tsai maintained a continuous, and larger, 95% controlling interest in MAS (Dkt.142 at 25), and therefore did not have to go through the trouble of reacquiring any shares from the 33 shareholders. In any event, to establish control the Commission need not demonstrate that Tsai did *exactly* "what the control persons did in *Kern*." Br.34-37.

Tsai also asserts that a "key factor" determinative of control is whether a person has the power to "cause the issuer to prepare and file a registration statement" (Br.46), which is a power that Tsai surely wielded, but withheld from exercising here. Tsai argues that none of the *33 shareholders* had the power to cause MAS to prepare and file a registration

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[13] Tsai repeatedly insists that the $250,000 he received was not *payment* for the 33 shareholders' *shares* but was Tsai's "*fee*" for "bringing about the reverse merger." Br.8-9, 12, 19. Even accepting Tsai's "fee" characterization, its payment demonstrates that Tsai controlled the reverse merger transaction.

statement (Br.46), but *Tsai* – not the 33 shareholders – controlled MAS, and the 33 shareholders were affiliates not because they controlled MAS, but because they were under Tsai's common control.

2. Tsai controlled the shareholders.

Contrary to Tsai's assertion that he had "limited authority" over the shareholders (Br.33-41), the record demonstrates that Tsai's control over them was expansive.

Tsai controlled the shareholders' ownership interests through his use of blank stock powers and his failure to issue stock certificates. *See Kern*, 425 F.3d at 149 (power over ownership interests demonstrates control); *M & A West*, 538 F.3d at 1052-54. Tsai's use of blank stock powers and his failure to issue stock certificates gave Tsai control to decide *whether* to transfer the shareholders' shares, the identity of the *transferee*, the *timing* of the transfer, the *amount* to transfer, and the *price* (if any) of the transfer.

Tsai concedes that he had all 33 shareholders sign blank stock powers so he could later "go back to type in the information" about the name of the transferee or the number of shares involved. Tsai.2002 159:18-24, 72:10-74:11; Dkt.125, Exh.27 (stock powers); Br.7. That the shareholders "signed the stock powers" and Tsai "explained" their purpose (Br.38-40) did not limit the control that Tsai was able to exercise with them. Tsai obtained a blank stock power from a shareholder who was mentally disabled and lacked the capacity to contract (Op.8), and Tsai was able to exercise the *same level* of authority over all the other shareholders through blank stock powers. Dkt.125, Exh.23.

Tsai also controlled all the shareholders' stock certificates. Although MAS's bylaws required stock certificates to be delivered to all 33 shareholders (Form 10-SB/A at 51-52 ¶7.01), Tsai never sent them. Tsai.2004 65:8-66:13, 222:22-223:18; Tsai.2002 108:2-12. When he so desired, Tsai was able to deliver the stock certificates directly to himself, and then Tsai sent them to Markow (along with a sheaf of stock powers), as part of the transfer of all of the shareholders' shares to the promoters. *Id.*; Dkt.125, Exh.27.

The combination of Tsai's blank stock powers and his ability to orchestrate when and how to issue stock certificates gave Tsai *complete* authority, rather than "*limited* authority," over the shareholders. The blank stock powers "rendered the certificates fully negotiable and freely transferable," and were "bearer instruments." *In re Legel, Braswell Gov. Sec. Corp.*, 648 F.2d 321, 324, 327 & n.11 (5th Cir.1981); *see also In re Legel Braswell Gov. Sec. Corp.*, 695 F.2d 506, 513 (11th Cir.1983) (same). Therefore, Tsai literally had a blank check to control the shareholders with respect to their shares.

Tsai argues that there is a factual dispute about what he subjectively "believed that each shareholder understood" based on their purported "confusion or lack of understanding or problems of recollection" regarding what Tsai said (Br.37-40), but the documentary evidence and Tsai's own testimony, as cited above, demonstrate that he had objective control over the shareholders' stock interests.

Tsai exercised control over the shareholders by transferring their shares at will. *See Kern*, 425 F.3d at 149 (orchestrating share transfers indicates control); *M & A West*, 538 F.3d at 1052-54. Contrary to Tsai's assertion in his brief that he "did not arrange for transfers of the MAS XI shares from any shareholder unless the shareholder did so," (Br.7, 39), Tsai admitted in his testimony that he was able to choose whether to transfer shares and the timing of the transfers at will. Tsai.2004 41:7-42:8, 147:15-20; Tsai.2002 159:18-24.

In fact, when Tsai used stock powers to transfer shares from the five individuals to an additional 28 people (Tsai.2004 112:10-14, 41:7-44:15), Tsai admits that he was able to choose the transferee and the amount of shares to transfer on a "*more or less arbitrary*" basis. Tsai.2004 108:8-110:6 (emphasis added); *see also* Tsai.2002 159:18-24. Likewise, Tsai transferred to the promoters in February 2000 all of the shareholders' stock powers and their stock certificates, certificates that the shareholders had never received and had been given directly to Tsai. Tsai.2004 222:22-223:18; Tsai.2002 72:10-74:11.

That the shareholders received $100 for their shares does not nullify Tsai's control, notwithstanding his claim that this was "the going market rate" for the shares. Br.37, 42. Rather, Tsai demonstrated his control because *he* decided to sell their shares at this price, and it was not a "market rate" determined at arms' length. Previously, Tsai had decided to transfer shares to the 28 additional shareholders without providing *any* compensation to the five purported directors. Dkt.125, Exh.28 at 177. Furthermore, the "market rate" characterization is also incoherent because

the shareholders were not compensated on a *pro rata* basis – every shareholder received $100, regardless of whether 15,000 or 135,000 of their shares were sold; therefore Tsai's purported "market price" inexplicably varied from $0.0067 to $0.0007. Helpingstine ¶13; Dkt.125, Exh.28 at 178; Tsai.2004 218:23-220:6. In addition, Tsai conceded that, when their shares were sold, the shareholders were unaware that the Form 211 process was complete or that a reverse merger agreement had been signed, and that both of these events had made their shares more valuable. Tsai.2004 227:11-228:20; Br.9. Finally, the price differential between the $250,000 that the promoters *paid* for the shareholders' shares on February 8, 2000 (Dkt.125, Exhs.33, 34, Dkt.113 218:7-19), and the $3,300 Tsai determined that the shareholders would *receive* less than one week later on February 14, 2000 (Dkt.125, Exh.37, Tsai.2004 218-23:220:6) is proof of Tsai's control. *Cf. Kern*, 425 F.3d at 150.

For the same reasons, there is no merit to Tsai's argument that he did not exercise control because each of the shareholders "kept or spent" the $100 for "his or her own use." Br.6, 8, 38. That Tsai did not control how the 33 individuals spent their money after Tsai sold and delivered their shares to the promoters does not diminish the control that Tsai exerted while they were shareholders. And even if the shareholders had torn the $100 checks into pieces, the share transfers that Tsai had orchestrated would still have been completed. *See Legel,* 648 F.2d at 324, 327 & n.11 (blank stock powers render stock certificates "bearer instruments").

Tsai's reliance on *Pennaluna & Co. v. SEC*, 410 F.2d 861 (9th Cir.1969) is misplaced. Contrary to Tsai's assertion (Br.45-46), the person who

controlled the shares in an escrow account had not yet become a controlling person of the issuer at the relevant time. *Id.* at 865-67 (accepting appellants' contention that although "he later occupied a position of control," he "was not in such a position * * * when the stock" at issue "was sold"). Tsai also relies on two inapposite Commission staff no-action letters (Br.43-45) – one dealing with a *bona fide* gift, and the other with an employee retirement plan, neither of which is present here – that in any event lack precedential effect. *See Christensen v. Harris County*, 529 U.S. 576, 587 (2000); *Federal Election Commission v. National Rifle Association*, 254 F.3d 173, 186 (D.C. Cir.2001); Op.41n.24.

Tsai's ability to dominate MAS, sell MAS, and ignore MAS's corporate formalities demonstrates that Tsai controlled the 33 minority shareholders. *See Kern*, 425 F.3d at 148-50. Tsai was able to "dominate the limited affairs pertinent to" MAS's shareholders (*id.*) because he: held every one of MAS's corporate offices; was MAS's controlling shareholder; sold a controlling interest in MAS through the reverse merger without the shareholders' awareness (Tsai.2004 227:11-228:20); and short-circuited the very components of MAS's corporate governance system (board of directors, shareholder meetings) that were designed to attenuate a control-person's power over minority shareholders. *See generally*, American Law Institute, *Principles of Corporate Governance* (1994).

C. Tsai is liable for violating Section 5.

Tsai's control over MAS and the shareholders defeats exemption under Section 4(1), and makes the safe harbor under Rule 144(k)

unavailable. In the absence of any recognized exemption, this Court should affirm summary judgment against Tsai for violating Section 5.

It is of no moment that Tsai himself did not sell the securities on the OTC Bulletin Board to the public. To hold that *direct* sales to the public is necessary would "be to ignore and render meaningless the language of section 5, which prohibits any person from 'directly or *indirectly*' engaging in the offer or sale of unregistered securities." *SEC v. Holschuh*, 694 F.2d 130, 139-40 (7th Cir.1982); *see also Geiger*, 363 F.3d at 487 (culpable defendant "did not have to be involved in the final step of the distribution"). Tsai is liable because he was indisputably a "necessary participant" and "substantial factor" in the ultimate public distribution. *SEC v. Murphy*, 626 F.2d 633, 649-52 (9th Cir.1980); *Holschuh*, 694 F.2d at 139-40. As the district court explained, Tsai's transfers expanding the number of MAS shareholders were "preliminary links in the daisy-chain of Tsai's overall plan to seek a profit from his shell company by securing public trading status and arranging a reverse merger which could inevitably lead to a public distribution." Op.43.

Indeed, Tsai testified that his "sole purpose" in creating MAS and issuing shares to himself and others was to generate publicly-trading shares, thereby making MAS "an attractive candidate for a prospective merger with a private company desiring to *go public.*" Tsai.Decl. ¶¶8-9 (emphasis added); *M & A West,* 538 F.3d at 1052-53 (where the "express purpose" of multiple transactions was "to transform a private corporation into a corporation selling stock shares to the public," there is "a *single* actual transaction with multiple stages"). Tsai accomplished this goal by

carefully orchestrating the various transfers between MAS's shareholders, transferring their shares to the promoters, and then executing the reverse merger. Like the defendant found liable in *Holschuh* – who also formed the issuer, served as its president, and signed the key contracts on the issuer's behalf – the record shows that Tsai's actions "intimately involved him in the details of numerous stages of a greater plan, of which he had in fact been a designer." *Holschuh*, 694 F.2d at 140; *see also SEC v. Phan*, 500 F.3d 895, 905-07 (9th Cir.2007) (affirming summary judgment against defendant who "directed" transactions but did not "participate" or "benefit" from sales to the public).

D. Tsai's remaining arguments concerning "industry custom," NASD approval of a Form 211, and an NASD letter are without merit and do not otherwise provide exemption from registration.

Tsai repeatedly asserts that he followed the "normal and customary procedure in the industry" with respect to reverse mergers, as if that fact, even if true, is significant to his Section 5 liability. Br.8-9, 12, 19, 38n.4, 53. However, as the district court correctly found, "[t]here is no 'industry custom' exemption to the registration requirement or to satisfying the required elements of the Rule 144(k) exemption." Op.39n.22. Reverse mergers, finders' fees, and modest payments to shell company shareholders are not *per se* unlawful, but here Tsai used these activities to violate Section 5. Indeed, one or more of these "customary procedures" were also used by the defendants whose Section 5 liability was affirmed in *M & A West*, *Cavanagh*, and *Kern*. *Cf.*, *Ganino v. Citizens Utilities Co.*, 228 F.3d 154 (2d Cir.2000) (even customary industry practices can be unlawful).

Nor is there any merit to Tsai's argument that the NASD's approval of MAS's Form 211 demonstrates that the sale of securities without registration here was "reasonable." Br.11-12, 25-27. As the NASD has made clear, and Tsai has conceded, in approving a Form 211 the "*NASD does not make findings of fact or law as to whether the shares are exempt from registration*," and the "NASD does not 'ultimately' decide whether the shares are freely tradeable." Br.26 (emphasis added). Indeed, the NASD's approval letter specifically gave Tsai "fair warning" (Br.25) that it had made no determination regarding compliance with Section 5 or Rule 144(k):

> Please be advised that in clearing [Kensington Capital]'s filing it should not be assumed that any federal, state, or self-regulatory requirements *other than* Rule 6740 and Rule 15c2-11 have been considered.

Dkt.125, Exh.29 (emphasis added). The examiner who reviewed this particular application and signed this approval letter (McClarin 21:21-22:7, 8:8-21) confirmed that the NASD "would not have arrived at any actual conclusion" as to whether or not an exemption was available because "the Form 211 process is not a merit review," therefore "there was not a decision made by myself or anyone else regarding that issue." McClarin 66:20-68:8, 77:14-78:3. Furthermore, Tsai's misrepresentations in the filings that were the basis of NASD's approval precludes any reliance on that

approval.[14] Accordingly, as the district court correctly concluded (Op.82-83), the NASD's approval of the Form 211 has no bearing on the availability of an exemption under Rule 144(k) or the reasonableness of Tsai's actions. Indeed, Tsai's reliance on the NASD's approval of the Form 211 as an exemption to registration was affirmatively *unreasonable*.

Finally, Tsai asserts that a letter sent from a staff member at the NASD to a staff member at the Commission asking for guidance about the treatment of "gifted shares" demonstrates that the NASD was generally "uncertain" about how to treat "gifted" shares of shell companies. Br.10-12, 54 (citing *NASD Regulation, Inc.*, SEC No-Action Letter, 2000 SEC No-Act. LEXIS 42 (January 21, 2000)). However, as explained above, Tsai's claimed "gifting" is irrelevant to his registration violation. Furthermore, because exemptions are narrowly construed, any purported "uncertainty" in determining the scope of exemption should be strictly construed *against* Tsai. *See Cavanagh*, 445 F.3d at 115; *Kern*, 425 F.3d at 153. In any event, this staff letter bound neither the NASD nor the Commission, and lacks the force of law. *See Christensen*, 529 U.S. at 587; *FEC v. NRA*, 254 F.3d at 186.

[14] The NASD "assume[s]" that the information presented to it is accurate (Br.26-27, McClarin 77:14-78:3); Tsai concedes that what he submitted to the NASD about MAS's compliance with corporate formalities was inaccurate. *See supra* at 12; Dkt.125, Exh.25 at 3 (Form 211 included Form 10-SB/A).

II. THERE WAS NO PREJUDICIAL VARIANCE BETWEEN THE SECTION 5 CLAIM ALLEGED IN THE COMMISSION'S COMPLAINT AND THE SECTION 5 CLAIM ON WHICH THE DISTRICT COURT GRANTED SUMMARY JUDGMENT.

Tsai asserts that the Commission's complaint stated a claim against him under Section 5 on "*fraud*"-based allegations and the district court improperly granted summary judgment against him on "*non-fraud*" allegations. *See* Br.16-27, 4-5. In Tsai's view, this amounted to a constructive amendment to the complaint, he lacked notice of this amendment, and he was entitled to additional discovery. Tsai's argument is meritless.

A. Because fraud is not an element of a violation of Section 5, there is no basis for Tsai's distinction between "fraud"-based and "non-fraud"-based violations of Section 5.

As the district court correctly concluded, there is no "legal distinction between a 'fraud violation of Section 5' and a 'non-fraud violation of Section 5,'" therefore Tsai's "argument is not well taken." Op.48. None of the elements of a Section 5 violation require fraud. *See Swenson*, 626 F.2d at 424; *SEC v. Calvo*, 378 F.3d 1211, 1215 (11th Cir.2004). For example, courts uniformly agree that Section 5 does not have any scienter requirement,[15] and Tsai concedes that "fraud or *scienter* is not a necessary element" of a Section 5 violation. Br.18n.1. This reflects the purpose of Section 5, which is to protect investors from even non-fraudulent conduct. *See Ralston*

[15] *See SEC v. North American Research and Development Corp.*, 424 F.2d 63, 81-82 (2d Cir.1970); *Swenson*, 626 F.2d at 424 (5th); *SEC v. Ross*, 504 F.3d 1130, 1137 (9th Cir.2007); *SEC v. Pearson*, 426 F.2d 1339, 1343 (10th Cir.1970); *Calvo*, 378 F.3d at 1215 (11th).

Purina., 346 U.S. at 124, 126-27 ("The design of [Section 5] is to protect investors by promoting full disclosure of information thought necessary to informed investment decisions"); Thomas Lee Hazen, 1 *Law Sec. Reg.* 2.2 (6th ed.2010) ("[S]ection 5 is not based on common law fraud."). To the extent that Tsai seeks to include such an element by inventing a distinct "fraud"-based Section 5 violation, his argument would subvert the legislative intent to prohibit all unregistered sales of securities.

B. The Commission's complaint provided Tsai notice of its claim that Tsai violated Section 5, irrespective of fraud.

Tsai argues that the Commission's complaint did not provide adequate notice because the complaint was "completely devoid" of allegations supporting a non-fraud claim against him based on his control. Br.4-5, 16-17, 24. Under the Federal Rules' liberal pleading requirements, a complaint need only provide "a short and plain statement of the claim" that gives a defendant "fair notice of what the * * * claim is and the grounds upon which it rests." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007) (quoting Fed.R Civ.P. 8(a)(2)). Here, the district court correctly concluded that the complaint "more than adequately" provided Tsai with notice of a non-fraud claim. Op.48.

The first count of the complaint sufficiently alleged a claim against Tsai for violating "Sections 5(a) and 5(c) of the Securities Act" (Dkt.1 at 18):

> Defendant[] Tsai * * * made use of the means or instruments of transportation or communication in interstate commerce or of the mails to offer and sell securities through the use or medium of a prospectus or otherwise when no registration statement has been filed or was in effect as to such securities * * *.

Dkt.1 at 18 & ¶78; *see also id.* at 3 ¶10; *compare with Swenson*, 626 F.2d at 424.

The complaint also described Tsai's role in "orchestrat[ing]" transactions to "funnel[] stock into the public trading market without a registration statement" (Dkt.1 at 18-19 ¶¶78-80), specifically that Tsai "formed MAS," transferred MAS stock to "approximately thirty shareholders," "arranged" a reverse merger, and that Tsai "retained control of the stock" before transferring it to the promoters (Dkt.1 at 2 ¶¶2-4, 11 ¶¶37-38). These are "direct or inferential allegations respecting all the material elements to sustain a recovery" on the Commission's non-fraud claim. *In re Commonwealth Institutional Securities, Inc.*, 394 F.3d 401, 405-06 (6th Cir.2005).

Notwithstanding the complaint's plain language, Tsai asserts that fraud was the "core of the claim" alleged against him, and summary judgment on a non-fraud claim constitutes an impermissible variance from the complaint. Br.18. An impermissible variance, or "shift in the thrust of the case," occurs when there is a prejudicial difference between the claim in the complaint and the claim subject to summary judgment. *See Colonial Refrigerated Transp., Inc. v. Worsham*, 705 F.2d 821, 825 (6th Cir.1983); *Aro Equipment Corp. v. Natkin & Co.*, 201 F.2d 160 (6th Cir.1952). For example, a variance may occur where a complaint "only" asserts a claim under the *Fourteenth* Amendment and a district court grants summary judgment on a *First* Amendment claim (*Summe v. Kenton County Clerk's Office*, 604 F.3d 257, 271 (6th Cir.2010)), or where a complaint contains allegations of a *federal* fraud claim, but "no allegation" regarding a *state* fraud claim, and a district court grants a form of relief available only under the state claim

(*Hail v. Heyman-Christiansen, Inc.*, 536 F.2d 908, 909 & n. 2 (10th Cir.1976), cited in *Worsham*).

Here, the Commission pled and proved Tsai's violation of Section 5; it is not as if the Commission charged Tsai only with fraud under Section 10(b), but sought summary judgment against him under Section 5. Indeed, the complaint charged ten other defendants – *but not Tsai* – with fraud in counts under Section 10(b), Rule 10b-5, and Section 17(a)(1). *See* Dkt.1 at 19-20 ¶¶81-85, 21-22 ¶¶90-94.

Contrary to his contention, the complaint's Section 5 claim is not converted into a fraud claim simply because the complaint refers to Tsai's role in a "scheme." The Commission alleged, and later demonstrated, that Tsai was a necessary participant and substantial factor in the overall scheme to distribute unregistered securities, not a scheme to defraud. *See* Dkt.1 at 2 ¶¶2-4, 3 ¶10, 11 ¶¶37-38, 18-19 ¶78-80. And violations of Section 5 often coexist with fraudulent schemes, just like the pump-and-dump scheme perpetrated by the other defendants in this case. *E.g.*, *Calvo*, 378 F.3d at 1213-15 (affirming judgment on Section 5 claims against Calvo and Section 10(b) claims against Diversified, where the complaint alleged they both "engaged in a 'pump and dump' *scheme*," and "Calvo's liability was predicated on strict liability whereas Diversified's liability was predicated on fraud") (emphasis added); *see also SEC v. Diversified Corporate Consulting Group*, 378 F.3d 1219 (11th Cir.2004).

Likewise, allegations that MAS's shareholders were Tsai's "nominees" whom Tsai "duped" through "sham" stock transfers does not transform the complaint's Section 5 claim into a fraud claim. Br.16-20, 3-4;

see also Dkt.1 at 2 ¶2, 10-11 ¶¶33-36. Although these words can be used in a fraud claim, their use is not so limited. Scienter allegations would be relevant for purposes of granting *relief* under Section 5. *See Universal Major*, 546 F.2d 1044 (injunction); *Kern*, 425 F.3d at 153 (civil penalties). In any event, the inclusion of "superfluous" words in a pleading is not grounds for variance, "at most" they are "harmless surplusage." *U.S. v. Autorino*, 381 F.3d 48, 54 (2d Cir.2004).

Moreover, from the outset the complaint repeatedly allged that even if Tsai may not have had title to the stock, Tsai "retained *control* of the stock during all relevant times." Dkt.1 at 2 ¶2 (emphasis added); *see also id.* at 10 ¶34 (Tsai had "control of the shares"), at 11 ¶36 ("Tsai controlled the stock"), ¶38 (Tsai "effectively controlled" the shareholders' shares). And although these allegations, if proven, would defeat exemptions to registration (*see* Argument I), the Commission was not, contrary to Tsai's misconception (Br.20), required to allege such facts; Tsai had the burden to plead and prove an exemption. *See Ralston Purina*, 346 U.S. at 126; *American Postal Workers Union v. Memphis*, 361 F.3d 898, 902 (6th Cir.2004).

Likewise, contrary to Tsai's assertions (Br.20-23), the Commission's interrogatory answers explained that Tsai controlled the issuance of shares, controlled the transfer or shares through blank stock powers that enabled him to "transfer the shares at will," and that "Tsai controlled the stock" ostensibly owned by the 33 shareholders. *See* Dkt.117, Att. 9, Exh.F (Responses to Tsai) ¶¶1(d), 2(d); *id.* at Exh.G (Responses to Goelo), at 4-5, 7-8; *id.* at Exh.H (Responses to Markow) at 4-5, 7, 13-14). Tsai was therefore on notice that his control over these shareholders was at issue in this case.

Finally, the Commission notes that Tsai's own answer to the complaint also demonstrates that he was on notice that no fraud claims were leveled against him. *See Pratt v. Tarr*, 464 F.3d 730, 732 (7th Cir.2006) ("responsive pleadings" demonstrate notice). Tsai's answer acknowledged that the fraud claims against other defendants under Section 10(b), Rule 10b-5, and Section 17(a)(1) do "not purport to state a claim for relief against Tsai." In contrast, Tsai affirmatively denied the Section 5 claim alleged against him. Dkt.18 ¶¶7-15. And Tsai did not plead any affirmative defense based on scienter, but rather, pled that the transactions were "exempt from registration under the federal securities laws and rules," thereby demonstrating his notice. Dkt.18 ¶¶29-30.

In any event, even if the Commission's complaint is construed to include some "fraud-based" claim against Tsai, the Commission is entitled to *also* plead a non-fraud claim under Section 5 in the alternative (Fed.R.Civ.P. 8(d)(2) & (3)), and obtain summary judgment *solely* on its non-fraud claim (Fed.R.Civ.P. 56(a), (c)). *E.g.*, *SEC v. Rubera*, 350 F.3d 1084, 1089, 1093-96 (9th Cir.2003) (affirming judgment under Section 5, but declining judgment on alternative fraud claim); *SEC v. Phan*, 500 F.3d 895 (same).

Tsai disagrees with this basic principle of federal pleading, arguing that the Commission is "precluded" from pleading both fraud and a non-fraud Section 5 claim in the alternative. Br.17-18. Tsai's argument is based on the "'theory of the pleadings' doctrine, under which a plaintiff must succeed on those theories that are pleaded or not at all," a doctrine which this Court holds "has been effectively abolished under the federal rules."

Worsham, 705 F.2d at 825, quoted at Op.48; *see also Ashcroft v. Iqbal*, 129 S.Ct. 1937, 1950 (2009) (the Federal Rules depart "from the hyper-technical, code-pleading regime of a prior era").

Tsai cites inapposite cases concerning the dismissal of claims under Rule 9(b) for failing to plead fraud with particularity, where, unlike here, the complaints were "*completely devoid of any*" non-fraud allegations. *E.g.*, *CALPERS v. Chubb Corp.*, 394 F.3d 126, 161 (3d Cir.2004) (emphasis added). Furthermore, these cases concern claims under *Section 11* of the Securities Act (15 U.S.C. 77k(a)), under which some courts have distinguished between a fraud claim and a non-fraud claim (*but see In re NationsMart Corp.*, 130 F.3d 309, 315 (8th Cir.1997)), while courts of appeals uniformly characterize *Section 5* claims as non-fraud claims. Tsai's cases also recognize that his proposed "theory of the pleadings" doctrine has been abolished. *E.g.*, *Lone Star Ladies Inv. Club v. Schlotzky's Inc.*, 238 F.3d 363, 368 (5th Cir.2001) ("Where averments of fraud are made in a claim in which

fraud is not an element, an inadequate averment of fraud does not mean that no claim has been stated").[16]

C. Tsai was not surprised or prejudiced by the entry of summary judgment based on a non-fraud claim.

Even if there was a variance, however, this Court should affirm summary judgment because Tsai did not suffer prejudice. *See SEC v. Happ*, 392 F.3d 12, 20-21 & n.3 (1st Cir.2004); *cf., U.S. v. Mills*, 366 F.2d 512, 514 (6th Cir.1966). The Commission's non-fraud Section 5 claim – as well as Tsai's control of MAS and the 33 shareholders – was alleged in the complaint and explored during discovery. Tsai had notice, but his efforts to provide "conflicting evidence" that he had only "limited authority" simply failed. Br.40-41.

Tsai argues that had he known that the Commission's claim against him was not based on fraud, he would have sought additional discovery regarding the industry custom for reverse mergers, the NASD's Form 211 approval process, and whether his position that shares were exempt from registration was a "reasonable interpretation of the law." Br.24-25.

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[16] Tsai proposes that this Court should, under Rule 9(b), "dismiss the SEC's complaint against Tsai" in its entirety (Br.57), but the cases he cites explain that "non-fraud allegations" do not have to "be stated with particularity merely because they appear in a complaint alongside fraud averments." *Vess v. Ciba-Geigy Corp.*, 317 F.3d 1097, 1104 (9th Cir.2003). In any event, Tsai waived this argument by filing an answer to the Commission's complaint that did not raise a Rule 9(b) objection. *See* Dkt.18; *Michaels Building Co. v. Ameritrust Co.*, 848 F.2d 674, 679 (6th Cir.1988); *see also Chubb*, 394 F.3d at 163-66 (affirming dismissal and denial of leave to amend *only where* the plaintiff had two opportunities to amend its complaint).

However, as explained in Argument I-D above, these subjects cannot demonstrate an exemption from registration, and none rebut Tsai's control. Furthermore, Tsai already conducted discovery on these inconsequential topics. *See* Br.9-10, 53 ("the report of defendants' expert Robert Rosen addressed common practices in the reverse merger industry") Dkt.120, Exh.4 (Rosen's expert report) at 2-16; Dkt.129 (Defendants' deposition of McClarin). Finally, the "reasonableness" of Tsai's interpretation of the *law* is not a proper subject for *factual* discovery. *See Molecular Technology Corp. v. Valentine*, 925 F.2d 910, 918-19 (6th Cir.1991).

D. The Commission's pursuit of the crime-fraud exception to Tsai's assertion of the attorney-client privilege was not inconsistent with finding Tsai liable for a non-fraud Section 5 violation.

Tsai points to the extensive briefing during discovery over whether certain evidence was admissible under the crime-fraud exception to the attorney-client privilege. After the complaint was filed, and during discovery, the NASD provided to the Commission an unsigned letter from an attorney sent to the NASD opining, based on information provided by Tsai, on the propriety of Form 211 approval. Dkt.125, Exh.28 at 179-80; Dkt.145 (District court's crime-fraud opinion) at 3-4. The NASD relied on this letter in approving MAS's Form 211. *Id.*; Dkt.125, Exh.29. When the Commission subpoenaed the attorney, who denied authorizing that letter for transmittal to the NASD, Tsai and other defendants claimed that the letter was protected by the attorney-client privilege. Dkt.69 (brief by Markow); Dkt.87 (brief by Tsai). The Commission argued that the crime-fraud exception to the attorney-client privilege applied to the letter and

related communications. Dkt.89. The district court affirmed the magistrate's order that the crime-fraud exception applied. Dkt.145. Tsai does not challenge that decision in this appeal.

Tsai reasons that because the Commission argued that the crime-*fraud* exception applied, the Commission thereby limited its Section 5 liability claims to a so-called "fraud-based" Section 5 violation. Br.23n.2. However, admissibility of evidence here had nothing to do with the elements of a cause of action. The Commission's pursuit of the crime-fraud exception during discovery did not alter or foreclose the non-fraud claim in its complaint. The Commission's crime-fraud argument was not based on any fraud allegation in the complaint. *See* Dkt.145 at 1-5, Dkt.89. Indeed, mere allegations of fraud "are not sufficient to make a *prima facie* showing that the crime-fraud exception applies." *In re Grand Jury Subpoena*, 419 F.3d 329, 336 (5th Cir.2005); *see also U.S. v. Chen*, 99 F.3d 1495, 1503 (9th Cir.1996) (same). Nor does the Commission's success in establishing the crime-fraud exception mean that the Commission "prove[d]" that Tsai committed fraud. *In re Antitrust Grand Jury*, 805 F.2d 155, 165-166 (6th Cir.1986). And even if the Commission had, in the course of establishing a crime-fraud exception, demonstrated that Tsai committed fraud, there is no support for

the proposition that the Commission would be foreclosed from demonstrating that Tsai was liable for a non-fraud Section 5 violation.[17]

Furthermore, Tsai's argument is disingenuous because both Tsai and the Commission (Dkt.89 at 6) acknowledged in the crime-fraud briefing below that the Commission's complaint did not allege a fraud claim against Tsai. Indeed, Tsai argued that the crime-fraud exception could not apply because "scienter is not an element of a § 5 violation." Dkt.87 at 3. The district court correctly concluded that the crime-fraud briefing provided Tsai "notice of the basis of the SEC's Section 5 claims." Op.50.

III. TSAI VIOLATED THE SHAREHOLDER REPORTING PROVISIONS OF SECTION 13(D), SECTION 16(A), AND RELATED RULES.

The district court correctly concluded that Tsai violated the Exchange Act's shareholder reporting provisions (Section 13(d)(1) and Rule 13d-1(a), and Section 16(a) and Rule 16a-3), because none of Tsai's filings with the Commission under the reporting provisions disclosed that Tsai was the "beneficial owner" of the shares held by 33 of MAS's shareholders. Dkt.244 at 1; Op.51-55.

A. Section 13(d) and Rule 13d-1(a)

Section 13(d)(1) and Rule 13d-1(a) require the beneficial owner of more than 5% of a company's securities to disclose his direct or indirect "beneficial ownership" of any shares by filing with the Commission a

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[17] The Commission sought the letter not to establish Tsai's liability for *violating* Section 5, but to provide added support for equitable *relief*, by showing that "Tsai acted willfully when he violated Section 5" (Dkt.89 at 7-10), and to explore Tsai's role, if any, in furthering the *other defendants*' alleged fraudulent scheme (Dkt.145 at 12-14).

Schedule 13D or Schedule 13G. *See* 15 U.S.C. 78m(d)(1)(D); 17 C.F.R. 240.13d-1(a).

Under these shareholder reporting provisions, Tsai was required to report his beneficial ownership of any shares over which he "directly or indirectly" had "voting power" or "investment power":

> (1) Voting power which includes the power to vote, or to direct the voting of, such security; and/or,
>
> (2) Investment power which includes the power to dispose, or to direct the disposition of, such security.

17 C.F.R. 240.13d-3(a).

Although Tsai had investment power and voting power over the five purported directors' shares, Tsai failed to report his beneficial ownership of these shares in his April 22, 1999 Schedule 13D. Dkt.125, Exh.1 ¶10, & decl.exh.E.

Tsai argues that he was not a beneficial owner of these shares because he had "limited authority" over the shares. Br.47-51. However, the same undisputed facts demonstrating that Tsai "controlled" these shares for purposes of defeating any exemption from registration (*see* Argument I), also demonstrate Tsai's direct or indirect "beneficial ownership" of these shares under the reporting provisions: blank stock powers and failure to issue stock certificates gave Tsai the "power to dispose" of these shares; Tsai's ability to transfer the shares to additional MAS shareholders and to the promoters demonstrates Tsai's power "to direct the disposition" of these shares; Tsai was the only member of MAS's board, held annual shareholder meetings by himself, and held shareholder meetings without

notice, therefore Tsai had the power to "direct the voting" of these securities.

Tsai also argues that because he reported his ownership of 8 million shares, Tsai was relieved of his obligation to report that he was also the beneficial owner of these shareholders' shares. Br.47-48, 50-51. However, Tsai's personal opinion that investors had sufficient information is irrelevant, as he violated the express terms of Section 13(d), which required Tsai, as the beneficial owner of more than 5% of MAS's securities, to disclose *any* shares that he beneficially owned. Tsai misled investors by falsely underreporting the extent of his beneficial ownership, thereby subverting these reporting provisions' purpose. *See GAF Corp. v. Milstein*, 453 F.2d 709, 720-21 (2d Cir.1971) ("a false filing may be more detrimental to the informed operation of the securities markets than no filing at all").

Finally, rehashing his variance argument, Tsai asserts that the Commission should be precluded from summary judgment on this reporting provision claim because it is part of a "non-fraud theory of liability," *i.e.*, it is based on the proposition "that Tsai had sufficient 'control' over the shares to render him liable." Br.51. However, the complaint gave sufficient notice of the Commission's claims against Tsai under the reporting provisions (Dkt.1 at 25 ¶108, 26-27 ¶119), and repeatedly alleged Tsai's "control" over the shares (*see* Argument II-B). In any event, scienter is not an element of a violation of these reporting provisions. *See SEC v. Savoy Ind.*, 587 F.2d 1149, 1167 (D.C. Cir.1978).

B. Section 16(a) and Rule 16a-3

Similarly, Section 16(a) and Rule 16a-3 require the beneficial owner of more than 10% of a company's securities to disclose whether he is a direct or indirect "beneficial owner" of any shares by filing with the Commission a Form 3, and disclosing changes in beneficial ownership, whether by acquisition or disposition, in a Form 4. *See* 15 U.S.C. 78p(a); 17 C.F.R. 240.16a-3.

Under these shareholder reporting provisions, Tsai was required to report his beneficial ownership of any shares in which he directly or indirectly had a "pecuniary interest," meaning:

> the *opportunity*, directly or indirectly, to profit or share *in any profit derived from a transaction* in the subject securities.

17 C.F.R. 240.16a-1(a)(2)(i) (emphasis added).

"Pecuniary interest" is defined broadly enough to embrace the $250,000 Tsai received here, whether the $250,000 is viewed as his direct payment for the 33 shareholders' shares, or merely his "fee" for his role in bringing about the reverse merger, without which these shares "were essentially worthless." Tsai.Decl. ¶11; *see also* Br.9 ("the shares were valueless unless a reverse merger occurred"). Tsai nonetheless filed a Form 3 on April 21, 1999 (Dkt.125, Exh.1 ¶10 & decl.exh.D) that failed to disclose his beneficial ownership of the shares held by the five purported directors, and another Form 3 on September 30, 1999 (*id*. & decl.exh.F) that failed to disclose his beneficial ownership of the shares (then held by 33 shareholders). And because Tsai failed to ever report his beneficial ownership of the 33 shareholders' shares, the Form 4 he filed on February

29, 2000 (*id.* & decl.exh.J) did not report the disposition of that beneficial ownership when the 33 shareholders' shares were sold.

Tsai asserts that the 33 shareholders received "the entire amount" of the profit from the sales of their stock (Br.48), but the district court was correct that the fact that "Tsai ultimately realized a $250,000 profit in connection with a disposition of the 250,000 shares warrants the conclusion that he had a pecuniary interest in those shares." Op.53-54. Indeed, the definition of "pecuniary interest" broadly includes "*any profit* derived from a transaction."

Tsai also asserts that "the time of the alleged reporting violation" was in April 1999, and at that time his pecuniary interest in the reverse merger was "speculative." Br.49-50. However, Tsai transferred these shares to additional persons for the express purpose of making MAS "an attractive candidate for a prospective merger" (Tsai.Decl. ¶9), which under these reporting provisions constituted an "opportunity" for his direct or indirect profit. Furthermore, even after Tsai received his $250,000 on February 8, 2000 (Dkt.125, Exh.35), Tsai failed to update the status of his beneficial ownership as required in the Form 4 he filed on February 29, 2000.

IV. THE REMEDIES ORDERED BY THE DISTRICT COURT WERE NOT AN ABUSE OF DISCRETION.

A. Disgorgement

Despite passing references (Br.2, 57), Tsai does not and cannot seriously contest the district court's broad discretion to order disgorgement of $250,000 plus prejudgment interest, which represents Tsai's unlawful profits from his participation in the securities law violations here. *See*

Dkt.244; Op.73-76; 15 U.S.C. 78u(d)(5); *Calvo*, 378 F.3d at 1217 (affirming disgorgement).

B. Permanent injunction against future violations

Because Tsai violated the registration and reporting provisions of the securities laws, and there is "a substantial likelihood of future violation," the district court acted within its broad discretion in ordering a permanent injunction. *Youmans*, 729 F.2d at 415; 15 U.S.C. 77t(b), 78u(d); Dkt.244. Contrary to Tsai's argument (Br.51-57), the factors this Court finds relevant support injunctive relief. *See Youmans*, 729 F.2d at 415; Op.79-83.

First and foremost in this case, Tsai's "occupation will present opportunities" for "future violations." *Youmans*, 729 F.2d at 415; *see also Swift & Co. v. U.S.*, 276 U.S. 311, 326 (1928) (injunctions deal "primarily" with a "threatened future" violation). As the facts here demonstrate, in accord with the Seventh Circuit's characterization, Tsai is in the business of providing "*services designed to evade the requirements that the Securities Act of 1933 imposes on companies that go public.*" *MAS Capital v. Biodelivery*, 524 F.3d at 833-34 (emphasis added).

The shell company Tsai used here is one of 101 shell companies that Tsai has at his disposal for future violations. Tsai.2004 25:8-26:9; Dkt.125, Exh.2. In a Wall Street Journal article titled "Tsai Cashes In on 'Blank Check' Firms Whenever Others Use Them to Go Public" (attached to Markow's declaration, Dkt.69, Exh.A), Tsai is quoted as bragging that he has "been very busy" starting public shell companies, and the article noted that Tsai has many shell companies "waiting in the wings." Tsai's website boasts that he has a "team of international specialists" to advise how to "go

public in the U.S. via reverse merger." *See* http://www.mascapital.com/. Accordingly, *reversing* the injunction here would enable Tsai to use these companies to commit future violations.

The "egregiousness" of Tsai's violations here (*Youmans*, 729 F.2d at 415) is demonstrated by his having been previously enjoined in *SEC v. Surgilight*, where, based on the Commission's allegation that Tsai violated Section 5 by participating in a public distribution using yet *another* one of his shell companies, a Florida district court entered a consent judgment against Tsai ordering disgorgement, civil penalties, and an injunction against Tsai's violating Section 5 in the future. *See SEC v. Surgilight Inc.*, SEC Litig.Rel.No. 17469, 2002 WL 535370 (Apr. 11, 2002); *SEC v. Surgilight Inc.*, SEC Litig.Rel.No. 19169, 2005 WL 770873. Tsai argues that *Surgilight* is irrelevant because Tsai "consented" to the injunction "without Tsai admitting or denying the allegations of registration violations." Br.53. However, because Tsai violated Section 5 here, his conduct was also a violation of the injunction entered in *Surgilight*, even if the *Surgilight* injunction was by consent. Accordingly, taking judicial notice of this previous consent judgment against Tsai was appropriate to "justify the permanent injunction" here. *CFTC v. Co Petro Marketing Group, Inc.*, 680 F.2d 573, 583-84 & n.16 (9th Cir.1982). Furthermore, the previous injunction shows Tsai's "familiarity" with the securities laws, and "rebut[s]" Tsai's contention that "his actions were, at worst, innocent, technical violations." *Id.*

Although scienter is not an element of a *violation* of Section 5, Tsai's recklessness in committing his violations also supports injunctive *relief*

here. *See Universal Major*, 546 F.2d 1044; *Youmans*, 729 F.2d at 415. As the district court properly determined, Tsai was at least "reckless in committing his violations," given that Tsai "lied" in his filings with both the Commission and the NASD. Op.81. The Form 10-SB that Tsai filed with the Commission, and made part of the Form 211 submitted to the NASD, contained several statements that Tsai concedes were inaccurate. *See supra* at 12. Tsai asserts that *one* of these conceded inaccuracies – that the five individuals did not receive "compensation" for their services as "directors" but performed no services and were "five of his friends" (*see* Form 10-SB/A at 27; Br.29; Tsai.Decl. ¶9) – does not demonstrate his scienter because *these particular* 1,250 shares, in contrast to the 250,000 shares he transferred to these five individuals, were not distributed to the public. Br.55. However, based on this misrepresentation, among the others contained in Tsai's filings, the NASD approved the Form 211 that permitted the listing of *all* the shares that were eventually distributed to the public. *See* McClarin 77:14-78:3. Tsai also argues that he honestly spoke to his *friends* about serving as "honorary directors" (Br.55-56), but Tsai lied to *regulators* by reporting that they were *bona fide* directors.

Tsai also argues that the NASD's approval of Kensington Capital's Form 211 and regulatory "uncertainty" somehow nullify his scienter (Br.53-54), but it was unreasonable for Tsai to view these as justification for his violations (*see* Argument I-D), especially where Tsai's consent to the judgment in *Surgilight* shows that his violation of Section 5 here was not "an innocent stumbling into an unintended transgression," because the previous injunction "laid down a specific admonitory prescription to guide

[his] future course." *U.S. v. Custer Channel Wing Corp.*, 376 F.2d 675, 682 (4th Cir.1967); *see also Co Petro*, 680 F.2d at 584.

In any event, Tsai is incorrect that "absent *scienter*, there is simply no basis for an injunction in this case." Br.53. Where, as here, scienter is not "an element of the substantive violation sought to be enjoined" (*Aaron*, 446 U.S. at 701), scienter "is not a prerequisite to injunctive relief" (*Calvo*, 378 F.3d at 1216). *See Youmans*, 729 F.2d at 415 ("the courts have taken care to stress that no one factor is determinative").

All the other relevant factors likewise support the district court's discretion in granting injunctive relief here. *See Youmans*, 729 F.2d at 415. Tsai has not provided any "assurances that [he] will not offend in [the] future," nor has Tsai "acknowledged in any way the wrongful nature of [his] conduct." Op.80. Tsai's "age and health" – he is in his early forties (Dkt.125, Exh.2) – also indicate Tsai is not lacking in vitality to commit future violations. *Youmans*, 729 F.2d at 415.

CONCLUSION

For the foregoing reasons, the judgment of the district court should be affirmed.

Respectfully submitted,

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DESIGNATION OF RELEVANT DISTRICT COURT DOCUMENTS

Pursuant to Circuit Rules 28(c) and 30(b)

Description	Docket #	Exhibit
Complaint	1	
Answer by Aaron Tsai	18	
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Deposition of Rick Hemmer, April 29, 2004	101	
Hemmer stock power	101	2
Deposition of Brian Kerney, Dec. 7, 2004	103	
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Declaration of Aaron Tsai ("Tsai.Decl.")	117	A
Commission's interrogatory responses	117, Att. 9	
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Responses to Goelo	117, Att. 9	Exh.G
Responses to Markow	117, Att. 9	Exh.H
Internet postings touting Bluepoint, March 5, 2000	118	70
Expert report of Robert Rosen (Defendants' expert)	120	4

Description	**Docket #**	**Exhibit**
Deposition of Aaron Tsai, October 19, 2004 ("Tsai.2004")	121	
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Tsai's Form 3 (April 21, 1999)	125	1 & decl.exh.D Tsai's
Schedule 13D (April 22, 1999)	125	1 & decl.exh.E
Tsai's Form 3 (Sept. 30, 1999)	125	1 & decl.exh.F
Tsai's Form 4 (Feb. 29, 2000)	125	1 & decl.exh.J
Background Questionnaire of Aaron Tsai	125	2
Deposition of Aaron Tsai, March 25, 2002 ("Tsai.2002")	125	3
Central Registration Depository Record of Aaron Tsai	125	4
Deposition of Michael Markow, March 1, 2002	125	6
MAS Form 10-SB, April 1999	125	21
MAS Form 10-SB/A, June 1999	125	22
Deposition of Natalie Hawkins, November 9, 2004	125	23
Form 211, filed with NASD, July 14, 1999	125	25
NASD rejection of Form 211, July 26, 1999	125	26
Stock powers and stock certificates	125	27
MAS stock transferor/transferee list	125	28, NASD 178
Unsigned attorney letter attached to Form 211	125	28, NASD 179-80
NASD approval of Form 211, Dec. 13, 1999	125	29

Description	Docket #	Exhibit
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Bluepoint Business Plan	125	31
Bluepoint Form 8-K, filed Feb. 18, 2000	125	32
Email from Goelo to Yang, Jan. 7, 2000	125	33
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CERTIFICATE OF COMPLIANCE

Pursuant to Fed.R.App.P. 32(a)(7)(C)

I hereby certify that pursuant to Fed.R.App.P. 32(a)(7)(C), the attached Corrected Brief of the Securities and Exchange Commission, Appellee, is proportionately spaced, has a typeface of 14 points or more (Book Antiqua), and contains 13,979 words.

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September 2010

CERTIFICATE OF SERVICE

I hereby certify that, on September 13, 2010, I caused a true and correct copy of the attached Corrected Brief of the Securities and Exchange Commission, Appellee, to be served electronically on counsel of record for Defendant-Appellant Aaron Tsai through the CM/ECF system:

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STATUTORY ADDENDUM

A. Registration Provisions

Section 5, 15 U.S.C. 77e (2000)

Prohibitions relating to interstate commerce and the mails

(a) Sale or delivery after sale of unregistered securities. Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly--

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) Necessity of prospectus meeting requirements of § 10 of this Act. It shall be unlawful for any person, directly or indirectly--

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this title [15 USCS §§ 77a et seq.], unless such prospectus meets the requirements of section 10 [15 USCS § 77j]; or

(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 10 [15 USCS § 77j(a)].

(c) Necessity of filing registration statement. It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 8 [15 USCS § 77h].

Section 4(1), 15 U.S.C. 77d (2000)

§ 77d. Exempted transactions

The provisions of section 5 [15 USCS § 77e] shall not apply to--

(1) transactions by any person other than an issuer, underwriter, or dealer.

Section 2(a)(11), 15 U.S.C. 77b(a)(11) (2000)

(11)The term "underwriter" means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

Rule 144, 17 C.F.R. 230.144 (2000)

Persons deemed not to be engaged in a distribution and therefore not underwriters.

PRELIMINARY NOTE Rule 144 is designed to implement the fundamental purposes of the Act, as expressed in its preamble, To provide full and fair disclosure of the character of the securities sold in interstate commerce and through the mails, and to prevent fraud in the sale thereof * * * The rule is designed to prohibit the creation of public markets in securities of issuers concerning which adequate current information is not available to the public. At the same time, where adequate current information concerning the issuer is available to the public, the rule permits the public sale in ordinary trading transactions of limited amounts of securities owned by persons controlling, controlled by or under common control with the issuer and by persons who have acquired restricted securities of the issuer.

Certain basic principles are essential to an understanding of the requirement of registration in the Act:

1. If any person utilizes the jurisdictional means to sell any nonexempt security to any other person, the security must be registered unless a statutory exemption can be found for the transaction.
2. In addition to the exemptions found in section 3, four exemptions applicable to transactions in securities are contained in section 4. Three of these section 4 exemptions are clearly not available to anyone acting as an underwriter of securities. (The fourth, found in section 4(4), is available only to those who act as brokers under certain limited circumstances.) An understanding of the term underwriter is therefore important to anyone who wishes to determine whether or not an exemption from registration is available for his sale of securities.

The term underwriter is broadly defined in section 2(11) of the Act to mean any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates, or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking. The interpretation of this definition has traditionally focused on the words with a view to in the phrase purchased from an issuer with a view to * * * distribution. Thus, an

investment banking firm which arranges with an issuer for the public sale of its securities is clearly an underwriter under that section. Individual investors who are not professionals in the securities business may also be underwriters within the meaning of that term as used in the Act if they act as links in a chain of transactions through which securities move from an issuer to the public. Since it is difficult to ascertain the mental state of the purchaser at the time of his acquisition, subsequent acts and circumstances have been considered to determine whether such person took with a view to distribution at the time of his acquisition. Emphasis has been placed on factors such as the length of time the person has held the securities and whether there has been an unforeseeable change in circumstances of the holder. Experience has shown, however, that reliance upon such factors as the above has not assured adequate protection of investors through the maintenance of informed trading markets and has led to uncertainty in the application of the registration provisions of the Act.

It should be noted that the statutory language of section 2(11) is in the disjunctive. Thus, it is insufficient to conclude that a person is not an underwriter solely because he did not purchase securities from an issuer with a view to their distribution. It must also be established that the person is not offering or selling for an issuer in connection with the distribution of the securities, does not participate or have a direct or indirect participation in any such undertaking, and does not participate or have a participation in the direct or indirect underwriting of such an undertaking.

In determining when a person is deemed not to be engaged in a distribution several factors must be considered.

First, the purpose and underlying policy of the Act to protect investors requires that there be adequate current information concerning the issuer, whether the resales of securities by persons result in a distribution or are effected in trading transactions. Accordingly, the availability of the rule is conditioned on the existence of adequate current public information.

Secondly, a holding period prior to resale is essential, among other reasons, to assure that those persons who buy under a claim of a section 4(2) exemption have assumed the economic risks of investment, and therefore are not acting as conduits for sale to the public of unregistered securities, directly or indirectly, on behalf of an issuer. It should be noted

that there is nothing in section 2(11) which places a time limit on a person's status as an underwriter. The public has the same need for protection afforded by registration whether the securities are distributed shortly after their purchase or after a considerable length of time.

A third factor, which must be considered in determining what is deemed not to constitute a distribution, is the impact of the particular transaction or transactions on the trading markets. Section 4(1) was intended to exempt only routine trading transactions between individual investors with respect to securities already issued and not to exempt distributions by issuers or acts of other individuals who engage in steps necessary to such distributions. Therefore, a person reselling securities under section 4(1) of the Act must sell the securities in such limited quantities and in such a manner as not to disrupt the trading markets. The larger the amount of securities involved, the more likely it is that such resales may involve methods of offering and amounts of compensation usually associated with a distribution rather than routine trading transactions. Thus, solicitation of buy orders or the payment of extra compensation are not permitted by the rule.

In summary, if the sale in question is made in accordance with all of the provisions of the section as set forth below, any person who sells restricted securities shall be deemed not to be engaged in a distribution of such securities and therefore not an underwriter thereof. The rule also provides thatany person who sells restricted or other securities on behalf of a person in a control relationship with the issuer shall be deemed not to be engaged in a distribution of such securities and therefore not to be an underwriter thereof, if the sale is made in accordance with all the conditions of the section.

(a)Definitions. The following definitions shall apply for the purposes of this section.

(1) An affiliate of an issuer is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer.

(2) The term person when used with reference to a person for whose account securities are to be sold in reliance upon this section includes, in addition to such person, all of the following persons:

(i) Any relative or spouse of such person, or any relative of such spouse, any one of whom has the same home as such person;

(ii) Any trust or estate in which such person or any of the persons specified in paragraph (a)(2)(i) of this section collectively own 10 percent or more of the total beneficial interest or of which any of such persons serve as trustee, executor or in any similar capacity; and

(iii) Any corporation or other organization (other than the issuer) in which such person or any of the persons specified in paragraph (a)(2)(i) of this section are the beneficial owners collectively of 10 percent or more of any class of equity securities or 10 percent or more of the equity interest.

(3) The term restricted securities means:

(i) Securities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering;

(ii) Securities acquired from the issuer that are subject to the resale limitations of § 230.502(d) under Regulation D or § 230.701(c);

(iii) Securities acquired in a transaction or chain of transactions meeting the requirements of § 230.144A;

(iv) Securities acquired from the issuer in a transaction subject to the conditions of Regulation CE (§ 230.1001);

(v) Equity securities of domestic issuers acquired in a transaction or chain of transactions subject to the conditions of § 230.901 or § 230.903 under Regulation S (§ 230.901 through § 230.905, and Preliminary Notes);

(vi) Securities acquired in a transaction made under § 230.801 to the same extent and proportion that the securities held by the security holder of the class with respect to which the rights offering was made were as of the record date for the rights offering "restricted securities" within the meaning of this paragraph (a)(3); and

(vii) Securities acquired in a transaction made under § 230.802 to the same extent and proportion that the securities that were tendered or exchanged in the exchange offer or business combination were "restricted securities" within the meaning of this paragraph (a)(3).

(b) Conditions to be met. Any affiliate or other person who sells restricted securities of an issuer for his own account, or any person who sells restricted or any other securities for the account of an affiliate of the issuer of such securities, shall be deemed not to be engaged in a distribution of such securities and therefore not to be an underwriter thereof within the meaning of section 2(11) of the Act if all of the conditions of this section are met.

(c) Current public information. There shall be available adequate current public information with respect to the issuer of the securities. Such information shall be deemed to be available only if either of the following conditions is met:

(1) Filing of reports. The issuer has securities registered pursuant to section 12 of the Securities Exchange Act of 1934, has been subject to the reporting requirements of section 13 of that Act for a period of at least 90 days immediately preceding the sale of the securities and has filed all the reports required to be filed thereunder during the 12 months preceding such sale (or for such shorter period that the issuer was required to file such reports); or has securities registered pursuant to the Securities Act of 1933, has been subject to the reporting requirements of section 15(d) of the Securities Exchange Act of 1934 for a period of at least 90 days immediately preceding the sale of the securities and has filed all the reports required to be filed thereunder during the 12 months preceding such sale (or for such shorter period that the issuer was required to file such reports). The person for whose account the securities are to be sold shall be entitled to rely upon a statement in whichever is the most recent report, quarterly or annual, required to be filed and filed by the issuer that such issuer has filed all reports required to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the issuer was required to file such reports) and has been subject to such filing requirements for the past 90 days, unless he knows or has reason to believe that the issuer

has not complied with such requirements. Such person shall also be entitled to rely upon a written statement from the issuer that it has complied with such reporting requirements unless he knows or has reasons to believe that the issuer has not complied with such requirements.

(2) Other public information. If the issuer is not subject to section 13 or 15(d) of the Securities Exchange Act of 1934, there is publicly available the information concerning the issuer specified in paragraphs (a)(5)(i) to (xiv), inclusive, and paragraph (a)(5)(xvi) of Rule 15c2-11 (§ 240.15c2-11 of this chapter) under that Act or, if the issuer is an insurance company, the information specified in section 12(g)(2)(G)(i) of that Act.

(d) Holding period for restricted securities. If the securities sold are restricted securities, the following provisions apply:

(1) General rule. A minimum of one year must elapse between the later of the date of the acquisition of the securities from the issuer or from an affiliate of the issuer, and any resale of such securities in reliance on this section for the account of either the acquiror or any subsequent holder of those securities. If the acquiror takes the securities by purchase, the one-year period shall not begin until the full purchase price or other consideration is paid or given by the person acquiring the securities from the issuer or from an affiliate of the issuer.

(2) Promissory notes, other obligations or installment contracts. Giving the issuer or affiliate of the issuer from whom the securities were purchased a promissory note or other obligation to pay the purchase price, or entering into an installment purchase contract with such seller, shall not be deemed full payment of the purchase price unless the promissory note, obligation or contract:

(i) Provides for full recourse against the purchaser of the securities;

(ii) Is secured by collateral, other than the securities purchased, having a fair market value at least equal to the purchase price of the securities purchased; and

(iii) Shall have been discharged by payment in full prior to the sale of the securities.

(3) Determination of holding period. The following provisions shall apply for the purpose of determining the period securities have been held:

(i) Stock dividends, splits and recapitalizations. Securities acquired from the issuer as a dividend or pursuant to a stock split, reverse split or recapitalization shall be deemed to have been acquired at the same time as the securities on which the dividend or, if more than one, the initial dividend was paid, the securities involved in the split or reverse split, or the securities surrendered in connection with the recapitalization;

(ii) Conversions. If the securities sold were acquired from the issuer for a consideration consisting solely of other securities of the same issuer surrendered for conversion, the securities so acquired shall be deemed to have been acquired at the same time as the securities surrendered for conversion;

(iii) Contingent issuance of securities. Securities acquired as a contingent payment of the purchase price of an equity interest in a business, or the assets of a business, sold to the issuer or an affiliate of the issuer shall be deemed to have been acquired at the time of such sale if the issuer or affiliate was then committed to issue the securities subject only to conditions other than the payment of further consideration for such securities. An agreement entered into in connection with any such purchase to remain in the employment of, or not to compete with, the issuer or affiliate or the rendering of services pursuant to such agreement shall not be deemed to be the payment of further consideration for such securities.

(iv) Pledged securities. Securities which are bona-fide pledged by an affiliate of the issuer when sold by the pledgee, or by a purchaser, after a default in the obligation secured by the pledge, shall be deemed to have been acquired when they were acquired by the pledgor, except that if the securities were pledged without recourse they shall be deemed to have been acquired by the pledgee at the time of the pledge or by the purchaser at the time of purchase.

(v) Gifts of securities. Securities acquired from an affiliate of the issuer by gift shall be deemed to have been acquired by the donee when they were acquired by the donor.

(vi) Trusts. Where a trust settlor is an affiliate of the issuer, securities acquired from the settlor by the trust, or acquired from the trust by the beneficiaries thereof, shall be deemed to have been acquired when such securities were acquired by the settlor.

(vii) Estates. Where a deceased person was an affiliate of the issuer, securities held by the estate of such person or acquired from such estate by the beneficiaries thereof shall be deemed to have been acquired when they were acquired by the deceased person, except that no holding period is required if the estate is not an affiliate of the issuer or if the securities are sold by a beneficiary of the estate who is not such an affiliate.

NOTE: While there is no holding period or amount limitation for estates and beneficiaries thereof which are not affiliates of the issurer, paragraphs (c), (h) and (i) of the rule apply to securities sold by such persons in reliance upon the rule.

(viii) Rule 145(a) transactions. The holding period for securities acquired in a transaction specified in Rule 145(a) shall be deemed to commence on the date the securities were acquired by the purchaser in such transaction. This provision shall not apply, however, to a transaction effected solely for the purpose of forming a holding company.

(e) Limitation on amount of securities sold. Except as hereinafter provided, the amount of securities which may be sold in reliance upon this rule shall be determined as follows:

(1) Sales by affiliates. If restricted or other securities are sold for the account of an affiliate of the issuer, the amount of securities sold, together with all sales of restricted and other securities of the same class for the account of such person within the preceding three months, shall not exceed the greater of

(i) One percent of the shares or other units of the class outstanding as shown by the most recent report or statement published by the issuer, or

(ii) The average weekly reported volume of trading in such securities on all national securities exchanges and/or reported through the automated quotation system of a registered securities association during the four calendar weeks preceding the filing of notice required by paragraph (h), or if no such notice is required the date of receipt of the order to execute the transaction by the broker or the date of execution of the transaction directly with a market maker, or

(iii) The average weekly volume of trading in such securities reported through the consolidated transaction reporting system contemplated by Rule 11Aa3-1 under the Securities Exchange Act of 1934 (§ 240.11A3-1) during the four-week period specified in paragraph (e)(1)(ii) of this section.

(2) Sales by persons other than affiliates. The amount of restricted securities sold for the account of any person other than an affiliate of the issuer, together with all other sales of restricted securities of the same class for the account of such person within the preceding three months, shall not exceed the amount specified in paragraphs (e)(1)(i), (ii) or (iii) of this section, whichever is applicable, unless the conditions of paragraph (k) of this rule are satisfied.

(3) Determination of amount. For the purpose of determining the amount of securities specified in paragraphs (e) (1) and (2) of this section, the following provisions shall apply:

(i) Where both convertible securities and securities of the class into which they are convertible are sold, the amount of convertible securities sold shall be deemed to be the amount of securities of the class into which they are convertible for the purpose of determining the aggregate amount of securities of both classes sold;

(ii) The amount of securities sold for the account of a pledgee thereof, or for the account of a purchaser of the pledged securities, during any period of three months within one year after a default in the obligation secured by the pledge, and the amount of securities sold during the same three-month period for the account of the pledgor shall not exceed, in the aggregate, the amount specified in paragraph (e) (1) or (2) of this section, whichever is applicable;

(iii) The amount of securities sold for the account of a donee thereof during any period of three months within one year after the donation, and the amount of securities sold during the same three-month period for the account of the donor, shall not exceed, in the aggregate, the amount specified in paragraph (e) (1) or (2) of this section, whichever is applicable;

(iv) Where securities were acquired by a trust from the settlor of the trust, the amount of such securities sold for the account of the trust during any period of three months within one year after the acquisition of the securities by the trust, and the amount of securities sold duringthe same three-month period for the account of the settlor, shall not exceed, in the aggregate, the amount specified in paragraph (e) (1) or (2) of this section, whichever is applicable;

(v) The amount of securities sold for the account of the estate of a deceased person, or for the account of a beneficiary of such estate, during any period of 3 months and the amount of securities sold during the same period for the account of the deceased person prior to his death shall not exceed, in the aggregate, the amount specified in paragraph (e) (1) or (2) of this section, whichever is applicable: Provided, That no limitation on amount shall apply if the estate or beneficiary thereof is not an affiliate of the issuer;

(vi) When two or more affiliates or other persons agree to act in concert for the purpose of selling securities of an issuer, all securities of the same class sold for the account of all such persons during any period of 3 months shall be aggregated for the purpose of determining the limitation on the amount of securities sold;

(vii) The following sales of securities need not be included in determining the amount of securities sold in reliance upon this section: securities sold pursuant to an effective registration statement under the Act; securities sold pursuant to an exemption provided by Regulation A (§ 230.251 through § 230.263) under the Act; securities sold in a transaction exempt pursuant to Section 4 of the Act (15 U.S.C. 77d) and not involving any public offering; and securities sold offshore pursuant to Regulation S (§ 230.901 through § 230.905, and Preliminary Notes) under the Act.

(f) Manner of sale. The securities shall be sold in brokers' transactions within the meaning of section 4(4) of the Act or in transactions directly with a market maker, as that term is defined in section 3(a)(38) of the Securities Exchange Act of 1934, and the person selling the securities shall not (1) solicit or arrange for the solicitation of orders to buy the securities in anticipation of or in connection with such transaction, or (2) make any payment in connection with the offer or sale of the securities to any person other than the broker who executes an order to sell the securities. The requirements of this paragraph, however, shall not apply to securities sold for the account of the estate of a deceased person or for the account of a beneficiary of such estate provided the estate or beneficiary thereof is not an affiliate of the issuer; nor shall they apply to securities sold for the account of any person other than an affiliate of the issuer provided the conditions of paragraph (k) of this rule are satisfied.

(g) Brokers' transactions. The term brokers' transactions in section 4(4) of the Act shall for the purposes of this rule be deemed to include transactions by a broker in which such broker:

(1) Does not more than execute the order or orders to sell the securities as agent for the person for whose account the securities are sold; and receives no more than the usual and customary broker's commission;

(2) Neither solicits nor arranges for the solicitation of customers' orders to buy the securities in anticipation of or in connection with the transaction; provided, that the foregoing shall not preclude

(i) inquiries by the broker of other brokers or dealers who have indicated an interest in the securities within the preceding 60 days,

(ii) inquiries by the broker of his customers who have indicated an unsolicited bona fide interest in the securities within the preceding 10 business days; or

(iii) the publication by the broker of bid and ask quotations for the security in an inter-dealer quotation system provided that such quotations are incident to the maintenance of a bona fide inter-dealer market for the security for the broker's own account and that the broker has published bona fide bid and ask quotations for the security in an inter-dealer quotation system on each of at least twelve days within the preceding thirty calendar days with no more than four business days in succession without such two-way quotations;

NOTE TO PARAGRAPH (g)(2)(ii): The broker should obtain and retain in his files written evidence of indications of bona fide unsolicited interest by his customers in the securities at the time such indications are received.

(3) After reasonable inquiry is not aware of circumstances indicating that the person for whose account the securities are sold is an underwriter with respect to the securities or that the transaction is a part of a distribution of securities of the issuer. Without limiting the foregoing, the broker shall be deemed to be aware of any facts or statements contained in the notice required by paragraph (h) of this section.

NOTES:

(i) The broker, for his own protection, should obtain and retain in his files a copy of the notice required by paragraph (h) of this section.

(ii) The reasonable inquiry required by paragraph (g)(3) of this section should include, but not necessarily be limited to, inquiry as to the following matters:

(a) The length of time the securities have been held by the person for whose account they are to be sold. If practicable, the inquiry should include physical inspection of the securities;

(b) The nature of the transaction in which the securities were acquired by such person;

(c) The amount of securities of the same class sold during the past 3 months by all persons whose sales are required to be taken into consideration pursuant to paragraph (e) of this section;

(d) Whether such person intends to sell additional securities of the same class through any other means;

(e) Whether such person has solicited or made any arrangement for the solicitation of buy orders in connection with the proposed sale of securities;

(f) Whether such person has made any payment to any other person in connection with the proposed sale of the securities; and

(g) The number of shares or other units of the class outstanding, or the relevant trading volume.

(h) Notice of proposed sale. If the amount of securities to be sold in reliance upon the rule during any period of three months exceeds 500 shares or other units or has an aggregate sale price in excess of $ 10,000, three copies of a notice on Form 144 shall be filed with the Commission at its principal office in Washington, DC; and if such securities are admitted to trading on any national securities exchange, one copy of such notice shall also be transmitted to the principal exchange on which such securities are so admitted. The Form 144 shall be signed by the person for whose account the securities are to be sold and shall be transmitted for filing concurrently with either the placing with a broker of an order to execute a sale of securities in reliance upon this rule or the execution directly with a market maker of such a sale. Neither the filing of such notice nor the failure of the Commission to comment thereon shall be deemed to preclude the Commission from taking any action it deems necessary or appropriate with respect to the sale of the securities referred to in such notice. The requirements of this paragraph, however, shall not apply to securities sold for the account of any person other than an affiliate of the issuer, provided the conditions of paragraph (k) of this rule are satisfied.

(i) Bona fide intention to sell. The person filing the notice required by paragraph (h) of this section shall have a bona fide intention to sell the securities referred to therein within a reasonable time after the filing of such notice.

(j) Non-exclusive rule. Although this rule provides a means for reselling restricted securities and securities held by affiliates without registration, it is not the exclusive means for reselling such securities in that manner. Therefore, it does not eliminate or otherwise affect the availability of any exemption for resales under the Securities Act that a person or entity may be able to rely upon.

(k) Termination of certain restrictions on sales of restricted securities by persons other than affiliates. The requirements of paragraphs (c), (e), (f) and (h) of this section shall not apply to restricted securities sold for the account of a person who is not an affiliate of the issuer at the time of the sale and has not been an affiliate during the preceding three months, provided a period of at least two years has elapsed since the later of the date the securities were acquired from the issuer or from an affiliate of the issuer. The two-year period shall be calculated as described in paragraph (d) of this section.

B. Shareholder Reporting Provisions

Section 13(d), 15 U.S.C. 78m(d) (2000)

(d)Reports by persons acquiring more than five per centum of certain classes of securities.

(1) Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is registered pursuant to section 12 of this title [15 USCS § 78l], or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of this title [15 USCS § 78l(g)(2)(G)], or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940 [15 USCS §§ 80a-1 et seq.] or any equity security issued by a Native Corporation pursuant to section 37(d)(6) of the Alaska Native Claims Settlement Act [43 USCS § 1629c(d)(6)], is directly or indirectly the beneficial owner of more than 5 per centum of such class shall, within ten days after such acquisition, send to the issuer of the security at its principal executive office, by registered or certified mail, send to each exchange where the security is traded, and file with the Commission, a statement containing such of the following information, and such additional information, as the Commission may by rules and regulations, prescribe as necessary or appropriate in the public interest or for the protection of investors—

(A) the background, and identity, residence, and citizenship of, and the nature of such beneficial ownership by, such person and all other persons by whom or on whose behalf the purchases have been or are to be effected;

(B) the source and amount of the funds or other consideration used or to be used in making the purchases, and if any part of the purchase price is represented or is to be represented by funds or other consideration borrowed or otherwise obtained for the purpose of acquiring, holding, or trading such security, a description of the transaction and the names of the parties thereto, except that where a source of funds is a loan made in the ordinary course of business by a bank, as defined in section 3(a)(6) of this title [15 USCS § 78c(a)(6)], if the person filing such statement so requests, the name of the bank shall not be made available to the public;

(C) if the purpose of the purchases or prospective purchases is to acquire control of the business of the issuer of the securities, any plans or proposals which such persons may have to liquidate such issuer, to sell its assets to or merge it with any other persons, or to make any other major change in its business or corporate structure;

(D) the number of shares of such security which are beneficially owned, and the number of shares concerning which there is a right to acquire, directly or indirectly, by (i) such person, and (ii) by each associate of such person, giving the background, identity, residence, and citizenship of each such associate; and

(E) information as to any contracts, arrangements, or understandings with any person with respect to any securities of the issuer, including but not limited to transfer of any of the securities, joint ventures, loan or option arrangements, puts or calls, guaranties of loans, guaranties against loss or guaranties of profits, division of losses or profits, or the giving or withholding of proxies, naming the persons with whom such contracts, arrangements, or understandings have been entered into, and giving the details thereof.

(2) If any material change occurs in the facts set forth in the statements to the issuer and the exchange, and in the statement filed with the Commission, an amendment shall be transmitted to the issuer and the exchange and shall be filed with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(3) When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a "person" for the purposes of this subsection.

(4) In determining, for purposes of this subsection, any percentage of a class of any security, such class shall be deemed to consist of the amount of the outstanding securities of such class, exclusive of any securities of such class held by or for the account of the issuer or a subsidiary of the issuer.

(5) The Commission, by rule or regulation or by order, may permit any person to file in lieu of the statement required by paragraph (1) of this subsection or the rules and regulations thereunder, a notice stating the name of such person, the number of shares of any equity securities subject to paragraph (1) which are owned by him, the date of their acquisition and such other information as the Commission may specify, if it appears to the Commission that such securities were acquired by such person in the ordinary course of his business and were not acquired for the purpose of and do not have the effect of changing or influencing the control of the issuer nor in connection with or as a participant having such purpose or effect.

(6) The provisions of this subsection shall not apply to--

(A) any acquisition or offer to acquire securities made or proposed to be made by means of a registration statement under the Securities Act of 1933 [15 USCS §§ 77a et seq.];

(B) any acquisition of the beneficial ownership of a security which, together with all other acquisitions by the same person of securities of the same class during the preceding twelve months, does not exceed 2 per centum of that class;

(C) any acquisition of an equity security by the issuer of such security;

(D) any acquisition or proposed acquisition of a security which the Commission, by rules or regulations or by order, shall exempt from the provisions of this subsection as not entered into for the purpose of, and not having the effect of, changing or influencing the control of the issuer or otherwise as not comprehended within the purposes of this subsection.

Rule 13d-1(a), 17 C.F.R. 240.13d-1(a)

(a) Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is specified in paragraph (i) of this section, is directly or indirectly the beneficial owner of more than five percent of the class shall, within 10 days after the acquisition, file with the Commission, a statement containing the information required by Schedule 13D (§ 240.13d-101).

Rule 13d-3(a), 17 C.F.R. 240.13d-3(a)

(a) For the purposes of sections 13(d) and 13(g) of the Act a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares:

(1) Voting power which includes the power to vote, or to direct the voting of, such security; and/or,

(2) Investment power which includes the power to dispose, or to direct the disposition of, such security.

Section 16(a), 15 U.S.C. 78p(a) (2000)

(a) Filing of statement of all ownership of securities of issuer by owner of more than ten per centum of any class of security. Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 of this title [15 USCS § 78l], or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 12(g) of this title [15 USCS § 78l(g)], or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership or if such person shall have purchased or sold a security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [15 USCS § 78c note]) involving such equity security during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership and such purchases and sales of such security-based swap agreements as have occurred during such calendar month.

Rule 16a-3, 17 C.F.R. 240.16a-3 (2000)

(a) Initial statements of beneficial ownership of equity securities required by section 16(a) of the Act shall be filed on Form 3. Statements of changes in beneficial ownership required by that section shall be filed on Form 4. Annual statements shall be filed on Form 5. At the election of the reporting person, any transaction required to be reported on Form 5 may be reported on an earlier filed Form 4. All such statements shall be prepared and filed in accordance with the requirements of the applicable form.

(b) A person filing statements pursuant to section 16(a) of the Act with respect to any class of equity securities registered pursuant to section 12 of the Act need not file an additional statement on Form 3:

(1) When an additional class of equity securities of the same issuer becomes registered pursuant to section 12 of the Act; or

(2) When such person assumes a different or an additional relationship to the same issuer (for example, when an officer becomes a director).

(c) Any issuer that has equity securities listed on more than one national securities exchange may designate one exchange as the only exchange with which reports pursuant to section 16(a) of the Act need be filed. Such designation shall be made in writing and shall be filed with the Commission and with each national securities exchange on which any equity security of the issuer is listed at the time of such election. The reporting person's obligation to file reports with each national securities exchange on which any equity security of the issuer is listed shall be satisfied by filing with the exchange so designated.

(d) Any person required to file a statement with respect to securities of a single issuer under both section 16(a) of the Act and either section 17(a) of the Public Utility Holding Company Act of 1935 or section 30(f) of the Investment Company Act of 1940 may file a single statement containing the required information, which will be deemed to be filed under both Acts.

(e) Any person required to file a statement under section 16(a) of the Act shall, not later than the time the statement is transmitted for filing with the Commission, send or deliver a duplicate to the person designated by the issuer to receive such statements, or, in the absence of such a designation, to the issuer's corporate secretary or person performing equivalent functions.

(f)(1) A Form 5 shall be filed by every person who at any time during the issuer's fiscal year was subject to section 16 of the Act with respect to such issuer, except as provided in paragraph (f)(2) of this section. The Form shall be filed within 45 days after the issuer's fiscal year end, and shall disclose the following holdings and transactions not reported previously on Forms 3, 4 or 5:

(i) All transactions during the most recent fiscal year that were exempt from section 16(b) of the Act, except:

(A) Exercises and conversions of derivative securities exempt under either § 240.16b-3 or § 240.16b-6(b) (these are required to be reported on Form 4);

(B) Transactions exempt from section 16(b) of the Act pursuant to § 240.16b-3(c), which shall be exempt from section 16(a) of the Act; and

(C) Transactions exempt from section 16(a) of the Act pursuant to another rule;

(ii) Transactions that constituted small acquisitions pursuant to § 240.16a-6(a);

(iii) All holdings and transactions that should have been reported during the most recent fiscal year, but were not; and

(iv) With respect to the first Form 5 requirement for a reporting person, all holdings and transactions that should have been reported in each of the issuer's last two fiscal years but were not, based on the reporting person's reasonable belief in good faith in the completeness and accuracy of the information.

(2) Notwithstanding the above, no Form 5 shall be required where all transactions otherwise required to be reported on the Form 5 have been reported before the due date of the Form 5.

NOTE: Persons no longer subject to section 16 of the Act, but who were subject to the Section at any time during the issuer's fiscal year, must file a Form 5 unless paragraph (f)(2) is satisfied. See also § 240.16a-2(b) regarding the reporting obligations of persons ceasing to be officers or directors.

(g) (1) A Form 4 shall be filed to report all transactions not exempt from section 16(b) of the Act and all exercises and conversions of derivative securities, regardless of whether exempt from section 16(b) of the Act.

(2) At the option of the reporting person, transactions that are reportable on Form 5 may be reported on Form 4, provided that the Form 4 is filed

no later than the due date of the Form 5 with respect to the fiscal year in which the transaction occurred.

(h) The date of filing with the Commission shall be the date of receipt by the Commission; Provided, however, That a Form 3, 4, or 5 shall be deemed to have been timely filed if the filing person establishes that the Form had been transmitted timely to a third party company or governmental entity providing delivery services in the ordinary course of business, which guaranteed delivery of the filing to the Commission no later than the required filing date.

(i) Signatures. Where Section 16 of the Act, or the rules or forms thereunder, require a document filed with or furnished to the Commission to be signed, such document shall be manually signed, or signed using either typed signatures or duplicated or facsimile versions of manual signatures. Where typed, duplicated or facsimile signatures are used, each signatory to the filing shall manually sign a signature page or other document authenticating, acknowledging or otherwise adopting his or her signature that appears in the filing. Such document shall be executed before or at the time the filing is made and shall be retained by the filer for a period of five years. Upon request, the filer shall furnish to the Commission or its staff a copy of any or all documents retained pursuant to this section.

(j) Where more than one person subject to section 16 of the Act is deemed to be a beneficial owner of the same equity securities, all such persons must report as beneficial owners of the securities, either separately or jointly. Where persons in a group are deemed to be beneficial owners of equity securities pursuant to § 240.16a-1(a)(1) due to the aggregation of holdings, a single Form 3, 4 or 5 may be filed on behalf of all persons in the group. Joint and group filings must include all required information for each beneficial owner, and such filings must be signed by each beneficial owner, or on behalf of such owner by an authorized person.

Rule 16a-1, 17 CFR 240.16a-1 (2000)

Terms defined in this rule shall apply solely to section 16 of the Act and the rules thereunder. These terms shall not be limited to section 16(a) of the Act but also shall apply to all other subsections under section 16 of the Act.

(a) The term beneficial owner shall have the following applications:

(1) Solely for purposes of determining whether a person is a beneficial owner of more than ten percent of any class of equity securities registered pursuant to section 12 of the Act, the term "beneficial owner" shall mean any person who is deemed a beneficial owner pursuant to section 13(d) of the Act and the rules thereunder; provided, however, that the following institutions or persons shall not be deemed the beneficial owner of securities of such class held for the benefit of third parties or in customer or fiduciary accounts in the ordinary course of business (or in the case of an employee benefit plan specified in paragraph (a)(1)(vi) of this section, of securities of such class allocated to plan participants where participants have voting power) as long as such shares are acquired by such institutions or persons without the purpose or effect of changing or influencing control of the issuer or engaging in any arrangement subject to Rule 13d-3(b) (§ 240.13d-3(b)):

(i) A broker or dealer registered under section 15 of the Act (15 U.S.C. 78o);

(ii) A bank as defined in section 3(a)(6) of the Act (15 U.S.C. 78c);

(iii) An insurance company as defined in section 3(a)(19) of the Act (15 U.S.C. 78c);

(iv) An investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8);

(v) Any person registered as an investment adviser under Section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3) or under the laws of any state;

(vi) An employee benefit plan as defined in Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended, 29 U.S.C. 1001 et seq. ("ERISA") that is subject to the provisions of ERISA, or any such plan that is not subject to ERISA that is maintained primarily for the benefit of the employees of a state or local government or instrumentality, or an endowment fund;

(vii) A parent holding company or control person, provided the aggregate amount held directly by the parent or control person, and directly and indirectly by their subsidiaries or affiliates that are not persons specified in paragraphs (a)(1)(i) through (ix), does not exceed one percent of the securities of the subject class;

(viii) A savings association as defined in Section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813);

(ix) A church plan that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940 (15 U.S.C. 80a-3); and

(x) A group, provided that all the members are persons specified in §240.16a-1(a)(1)(i) through (ix).

(xi) A group, provided that all the members are persons specified in § 240.16a-1(a)(1) (i) through (vii).

NOTE TO PARAGRAPH (A). Pursuant to this section, a person deemed a beneficial owner of more than ten percent of any class of equity securities registered under section 12 of the Act would file a Form 3 (§ 249.103), but the securities holdings disclosed on Form 3, and changes in beneficial ownership reported on subsequent Forms 4 (§ 249.104) or 5 (§ 249.105), would be determined by the definition of "beneficial owner" in paragraph (a)(2) of this section.

(2) Other than for purposes of determining whether a person is a beneficial owner of more than ten percent of any class of equity securities registered under Section 12 of the Act, the term beneficial owner shall mean any person who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has or shares a direct or indirect pecuniary interest in the equity securities, subject to the following:

(i) The term pecuniary interest in any class of equity securities shall mean the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in the subject securities.

(ii) The term indirect pecuniary interest in any class of equity securities shall include, but not be limited to:

(A) Securities held by members of a person's immediate family sharing the same household; provided, however, that the presumption of such beneficial ownership may be rebutted; see also § 240.16a-1(a)(4);

(B) A general partner's proportionate interest in the portfolio securities held by a general or limited partnership. The general partner's proportionate interest, as evidenced by the partnership agreement in effect at the time of the transaction and the partnership's most recent financial statements, shall be the greater of:

(1) The general partner's share of the partnership's profits, including profits attributed to any limited partnership interests held by the general partner and any other interests in profits that arise from the purchase and sale of the partnership's portfolio securities; or

(2) The general partner's share of the partnership capital account, including the share attributable to any limited partnership interest held by the general partner.

(C) A performance-related fee, other than an asset-based fee, received by any broker, dealer, bank, insurance company, investment company, investment adviser, investment manager, trustee or person or entity performing a similar function; provided, however, that no pecuniary interest shall be present where:

(1) The performance-related fee, regardless of when payable, is calculated based upon net capital gains and/or net capital appreciation generated from the portfolio or from the fiduciary's overall performance over a period of one year or more; and

(2) Equity securities of the issuer do not account for more than ten percent of the market value of the portfolio. A right to a nonperformance-related fee alone shall not represent a pecuniary interest in the securities;

(D) A person's right to dividends that is separated or separable from the underlying securities. Otherwise, a right to dividends alone shall not represent a pecuniary interest in the securities;

(E) A person's interest in securities held by a trust, as specified in § 240.16a-8(b); and

(F) A person's right to acquire equity securities through the exercise or conversion of any derivative security, whether or not presently exercisable.

(iii) A shareholder shall not be deemed to have a pecuniary interest in the portfolio securities held by a corporation or similar entity in which the person owns securities if the shareholder is not a controlling shareholder of the entity and does not have or share investment control over the entity's portfolio.