

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION**

In re:)	
)	Chapter 11
)	
SORRENTO THERAPEUTICS, INC., <i>et al.</i> ¹)	Case No. 23-90085 (DRJ)
)	
Debtors.)	
)	

**SCILEX HOLDING COMPANY’S EMERGENCY MOTION FOR ENTRY OF AN
ORDER COMPELLING THE PRODUCTION OF BOOKS AND RECORDS FROM THE
BROKERAGE FIRMS PURSUANT TO RULE 2004 OF THE FEDERAL RULES OF
BANKRUPTCY PROCEDURE**

Emergency relief has been requested. Relief is requested not later than November 10, 2023.

If you object to the relief requested or you believe that emergency consideration is not warranted, you must appear at the hearing if one is set or file a written response prior to the date that relief is requested in the preceding paragraph. Otherwise, the Court may treat the pleading as unopposed and grant the relief requested.

Scilex Holding Company (“Scilex”), by and through their undersigned counsel, as party in interest in the above-captioned case, hereby respectfully moves this Court for entry of an order pursuant to Rule 2004 of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”) compelling written responses to certain Information Requests (as defined below) from the brokers, dealers, banks and other nominees listed on Exhibit A hereto (the “Brokerage Firms”), and third parties including the Depository Trust Clearing Corporation (“DTCC”), Broadridge Financial Solutions Inc (“Broadridge”) and the Financial Industry Regulatory Authority (“FINRA”) listed on Exhibit A. In support of this motion (the “Motion”), Scilex respectfully states as follows:

¹ The Debtor entities in these chapter 11 cases, along with the last four digits of each Debtor entity’s federal tax identification number, are: Sorrento Therapeutics, Inc. (4842) and Scintilla Pharmaceuticals, Inc. (7956). The Debtors’ service address is: 4955 Directors Place, San Diego, CA 92121.

Jurisdiction

1. The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334. Venue is proper pursuant to 28 U.S.C. §§ 1408 and 1409. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2).

2. The statutory predicates for the relief sought herein are 11 U.S.C. § 105(a), Bankruptcy Rules 2004 and 9016, and Federal Rules of Civil Procedure 30, 31 and 45.

3. Pursuant to this *Court's Order Granting Debtors' Motion to Quash Notice of Examination of Sorrento Therapeutics, Inc. Pursuant to Bankruptcy Rule 2004* [Docket No. 161], Scilex is seeking this relief by motion, in strict compliance with Bankruptcy Rule 2004. Given the Court's temporary suspension of Bankruptcy Local Rule 2004-1, the Debtors did not seek to meet-and-confer with the Brokerage Firms prior to filing the Motion.

Background

4. On February 13, 2023 (the "Petition Date"), the above-captioned debtors and debtors in possession (collectively, the "Debtors") filed voluntary petitions for relief under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code"). A detailed description of the Debtors, their businesses, and the facts and circumstances supporting the Debtors' chapter 11 cases are set forth in greater detail in the *Declaration of Mohsin Meghji, Chief Restructuring Officer of the Debtors, in Support of Chapter 11 Petitions* [Docket No. 5] (the "First Day Declaration").

5. The Debtors' most significant and valuable asset was and is an equity interest in Scilex Holding Company ("Scilex"), which is a publicly traded company on the NASDAQ. On February 10, 2023, the last business day before the Petition Date, Scilex had a closing trading price of \$9.61 which made Sorrento's approximately 59 million shares of common stock of Scilex (the "Scilex Common Stock") and approximately 29 million shares of Scilex Series A Preferred Stock (the "Scilex Preferred Stock") worth a combined total of approximately \$850 million. (First Day

Declaration ¶ 12 [Docket No. 5].) Immediately following a merger involving Scilex in November 2022, Sorrento owned 96.2% of Scilex Common Stock, which was subject to a 180-day lock-up agreement. Pursuant to the terms of the Amended and Restated Registration Rights Agreement of Scilex, dated November 10, 2022, Sorrento was restricted from transferring its shares of Scilex Common Stock until May 11, 2023, subject to certain exceptions specified therein (including dividends).

6. On January 23, 2023, the Debtor distributed a dividend to its shareholders of 76,000,000 shares of Scilex Common Stock (the “Scilex Dividend Shares” or “Dividend Shares”). The issuance of the Dividend Shares reduced Sorrento’s ownership interest in Scilex Common Stock from 96.2% to 42.5%. The Dividend Stock was received by each “record owner,” who were brokers, dealers, banks and other nominees acting as agents for the shareholders (*e.g.*, the “Beneficial Owners”). The Brokerage Firms held, in the aggregate, approximately 89.5% of the shares of Dividend Stock that were transferred to the Sorrento shareholders pursuant to the Sorrento Dividend. The Brokerage Firms, as record owners, held the shares of Scilex distributed under the Sorrento Dividend in custody as agents for the Sorrento shareholders, who were the Beneficial Owners. Sorrento shareholders who received the Dividend Stock were similarly restricted from transferring the Dividend Stock until May 11, 2023.

7. In anticipation of its annual shareholder meeting which was to occur on April 6, 2023, Scilex determined that the record date for the shareholders entitled to receive notice of and vote at the annual shareholder meeting was March 6, 2023 (the “Meeting Record Date”). Scilex filed proxy materials with the Securities and Exchange Commission (“SEC”), in compliance with its obligations under the federal securities laws. Contrary to normal practice, however, the proxy materials mandated to be delivered to the Beneficial Owners of more than 44,000,000 shares of

Scilex Common Stock had not been delivered. The brokers, dealers, banks and other nominees that act as agents for the Sorrento shareholders had failed to report the ownership of such shares to Broadridge Financial Solutions, Inc. (“Broadridge”), the entity designated to collect, verify, and tabulate shareholder votes for the annual meeting. *See* Scilex Press Release dated March 27, 2023.² Sorrento, as the owner of a majority of shares of Scilex, after taking into account the voting power of the Scilex Preferred Stock that is held by Sorrento, was therefore faced with a corporate governance dilemma—a substantial number of minority shareholders of Scilex may have been disenfranchised by the inexplicable failure of the Brokerage Firms to report all holdings of Scilex Common Stock (notwithstanding their obligation to do so) and to deliver proxy materials in compliance with federal securities laws, thereby impairing the ability to operate (and thus the value) of Sorrento’s largest asset.

8. On March 31, 2023, the Debtor filed *Debtors’ Emergency Motion for Entry of an Order Compelling Written Responses from Brokerage Firms Pursuant to Rule 2004 of the Federal Rules of Bankruptcy Procedure* [Docket No. 330] (the “Rule 2004 Motion”). The Rule 2004 Motion sought, *inter alia*, an order compelling Brokerage Firms³ to provide written responses to Information Requests (as defined below) on or before April 5, 2023. The Information Requests sought information regarding which the Brokerage Firms had failed to report, or had underreported, the ownership of Scilex Common Stock so that they may seek to remedy such failure and its effect on Scilex’s stock value. As the Rule 2004 Motion explains, the Debtors

² Available at <https://www.scilexholding.com/scilex-holding-company-reports-substantial-underreporting-of-more-than-44-million-shares-of-its-common-stock-by-brokerage-firms-for-the-upcoming-annual-meeting-of-stockholders-scheduled-for-april-6-2/>.

³ The Brokerage Firms listed herein is more expansive than the Brokerage Firms listed in the prior Rule 2004 Motion, as such reference made to the prior Rule 2004 Motion Brokerage Firms refers to some but not all of the Brokerage Firms listed in the present motion.

believed that a substantial number of minority shareholders of Scilex may have been actually or functionally disenfranchised by the Brokerage Firms' failure to report all holdings of Scilex Common Stock and to deliver proxy materials in compliance with federal securities laws. On April 11, 2023, the Court entered an order approving the Rule 2004 Motion. *See Amended Order Granting Debtors' Rule 2004 Motion* [Dkt. No. 395].

9. The Debtors received few responses to their Information Requests from the Brokerage Firms. On May 11, 2023, the Official Committee of Equity Securities Holders (the "Equity Committee") of the Debtors filed *Official Committee of Equity Securities Holders' Emergency Motion Seeking to Compel Certain Brokerage Firms' Compliance with Various Regulatory Requirements* [Docket No. 594] ("Equity Committee's Motion"), stating that, based on information provided by the Debtors, it "understands that nearly all responses were inadequate, incomplete, and/or did not resolve the uncertainties surrounding the reporting of Scilex Common Stock." ¶ 10. The Equity Committee's Motion sought to compel the Brokerage Firms to ensure Scilex stock was properly recorded and segregated in their customers' accounts in compliance with applicable regulatory requirements. *See id.* ¶ 12. On May 12, 2023, the Court entered an order granting, in part, the Equity Committee's Motion. *See Order Compelling Brokerage Firms' Compliance with Various Regulatory Requirements* [Docket No. 609]. Following this Order, the Brokerage Firms still have not provided sufficient responses, as explained in more detail below, and uncertainties surrounding the reporting of Scilex Common Stock still remains.

10. On September 21, 2023, the Debtors filed their *Notice of Closing of Scilex Stock Sale and Related Definitive Documentation* [Docket No. 1356] confirming the sale of 60,068,585 shares of Scilex Common Stock, 29,057,097 shares of Scilex Series A Preferred Stock, and 1,386,617 in exercisable warrants of Scilex common stock to Scilex for the aggregate purchase of

\$100,000,000.00 (through an assumption of the Oramed debtor in possession financing), credit bid pursuant to section 363(k) of the Bankruptcy Code, \$5 million dollars as an advance of payment, and additional \$5 million dollars to be paid at closing (the “Scilex Transaction”). The value of Scilex stock as contemplated through the Scilex Transaction was \$1.23/share. Accordingly, Scilex stock, Debtor’s most significant asset, lost \$8.38 per share, or about 87% of its value from the Petition Date to the date the stock was sold in the Scilex Transaction. Scilex believes that this loss resulted from the Brokerage Firms naked short selling Scilex stock and the Scilex Transaction was made into a manipulated market. This significantly damaged Scilex and Debtor’s bankruptcy estate and the damage is at least partially attributable to Brokerage Firm’s illegal acts.

11. By this motion, Scilex, as a party in interest, renews the requests for information from Brokerage Firms that were sought in the Rule 2004 Motion and Equity Committee Motion, and already ordered by this Court to be provided, to obtain information sufficient to determine whether Brokerage Firms participated in naked short selling that damaged Scilex and Debtor’s bankruptcy estate.⁴ Debtors and Equity Committee have no objection to the present motion.

a. Short Selling

12. There is a fundamental difference between naked short selling and short selling. Short selling is a legitimate trading strategy that is regulated by the SEC. Short selling occurs when a market participant, who does not own any shares of a company, believes that the security is overpriced and is on the verge of declining in price. In order to lawfully profit from the projected drop in share price, the short seller will place an order to sell with its broker, shares that it does not own.

⁴ On information and belief, Debtors lacked the funding to continue the pursuit of information from Brokerage Firms, so Scilex, by and through its attorneys, brings the present motion as a party in interest.

13. After locating and selling the shares that it has borrowed, the short seller will “cover” the sale by buying in the open market the same amount of shares it originally borrowed and sold, at a market price that is lower than the price it paid to the lender to borrow the shares, and return the shares to the lender. The profit a short seller earns is the difference between the price at which it sold the borrowed shares and the price it paid to repurchase the shares that are returned to the lender, net of borrowing costs and commissions paid to the lender.

14. The SEC describes short selling as follows:

A short sale is the sale of a security that the seller does not own and any sale that is consummated by the delivery of a security borrowed by, or for the account of, the seller. In order to deliver the security to the purchaser, the short seller will borrow the security, usually from a broker-dealer or an institutional investor. Typically, the short seller later closes out the position by purchasing equivalent securities on the open market and returning the borrowed security to the lender. In general, short selling is used to profit from an expected downward price movement, to provide liquidity in response to unanticipated demand, or to hedge the risk of an economic long position in the same security or in a related security.⁵

b. Regulation SHO

15. As trading technology and strategies evolved and became more sophisticated, the SEC adopted Regulation SHO in 2004 (“Reg SHO”), it went into effect January 1, 2005.⁶ The primary impetus for the adoption of Reg SHO was to address the SEC’s concerns regarding persistent fails to deliver and abusive naked short selling caused by those fails to deliver.⁷ Reg SHO adopted a multi-faceted approach for dealing with manipulative naked short selling. Reg SHO Rule 203 (b)(i) prohibits a broker from accepting a short sale order of an equity security unless the broker has 1) borrowed the security; 2) entered into a bona-fide arrangement to borrow

⁵ S.E.C., Division of Market Regulation: Responses to Frequently Asked Questions Concerning Regulation SHO, <https://www.sec.gov/divisions/marketreg/mrfaqregsho1204.htm>.

⁶ See Regulation SHO, Exchange Act Release No. 50,103, 69 Fed. Reg. 48,008, 48,008 (Aug. 6, 2004) (codified at 17 C.F.R. §242.200-203); S.E.C., *Key Points About Regulation SHO*, <https://www.sec.gov/investor/pubs/regsho.htm>.

⁷ See S.E.C., *Key Points About Regulation SHO*, <https://www.sec.gov/investor/pubs/regsho.htm>.

the security, or 3) has reasonable grounds to believe that a security can be borrowed so it can be timely delivered on the delivery date (“Locate Requirement”). Additionally, Reg SHO requires that if the seller fails to deliver the shares to the buyer, by a certain date, the short sale transaction is to be “closed out.”

c. Naked Short Selling

16. Naked short selling is an unlawful form of market manipulation where a short seller does not borrow or arrange to borrow the securities in time to make delivery within the standard two day settlement period (known as “failure to deliver” or “fail”).⁸ The naked short seller fails to deliver the shares to the buyer within two days and never purchases the shares in the market to cover their position and deliver the shares to the buyer. Rather, in a naked short selling scheme, “Phantom” or “Counterfeit” shares are essentially being sold to an unsuspecting buyer. As explained *infra*, prolonged failures to deliver caused by manipulative naked short selling violate federal securities laws.⁹

17. By failing to deliver the stock for a prolonged period, the buyer is prevented from actually owning shares. The buyer instead receives an electronic book entry denoting ownership of the shares, but no actual shares support the entry. This also allows millions of shares to be sold that are not real, and in fact, are unregistered and counterfeit.

18. In November of 2007, former SEC Chairman Harvey Pitt derided the practice of naked short selling, stating: “Phantom shares created by naked shorting are analogous to counterfeit money.” Similarly, during a February 14, 2008 Senate Banking Committee Hearing, Senator Robert Bennett commented that through naked short selling it is becoming “increasingly

⁸ See S.E.C., *Key Points About Regulation SHO*, <https://www.sec.gov/investor/pubs/regsho.htm>.

⁹ *Id.*

. . . easier in this electronic world to give you counterfeit shares.” The SEC also reaffirmed its “. . . zero tolerance for abusive naked short selling” by strengthening investor protection. Indeed, the SEC has recognized that “selling stock short and failing to deliver shares at the time of settlement with the purpose of driving down the security’s price” constitutes a “manipulative activity” that “in general, would violate various securities laws.”¹⁰

19. The pernicious effects of naked short selling have been described by the SEC as follows:

[W]e are concerned that large and persistent fails to deliver may have a negative effect on the market in these securities. For example, large and persistent fails to deliver may deprive shareholders of the benefits of ownership, such as voting and lending. In addition, where a seller of securities fails to deliver securities on trade settlement date, in effect the seller unilaterally converts a securities contract (which should settle within the standard 3-day settlement period) into an undated futures-type contract, to which the buyer may not have agreed, or that may have been priced differently. Moreover, sellers that fail to deliver securities on trade settlement date may enjoy fewer restrictions than if they were required to deliver the securities within a reasonable period of time, and such sellers may attempt to use this additional freedom to engage in trading activities that deliberately and improperly depress the price of a security.

In addition, many issuers and investors continue to express concern about extended fails to deliver in connection with “naked” short selling. To the extent that large and persistent fails to deliver might be indicative of manipulative “naked” short selling, which could be used as a tool to drive down a company’s stock price, fails to deliver may undermine the confidence of investors. These investors, in turn, may be reluctant to commit capital to an issuer they believe to be subject to such manipulative conduct. In addition, issuers may believe that they have suffered unwarranted reputational damage due to investors’ negative perceptions regarding large and persistent fails to deliver. Any unwarranted reputational damage caused by large and persistent fails to deliver might have an adverse impact on the security’s price¹¹

20. In other words, a prolonged failure to deliver shares effectively allows the naked short seller to deliver the shares at a future date that is in its best interest, rather than settle within

¹⁰ *Id.*; see also SEC Release No. 34-.57511, p. 3, File No. S7-08-08 (Mar. 17, 2008).

¹¹ See SEC Release No. 34-56212, available at: <https://www.sec.gov/files/rules/final/2007/34-56212.pdf>.

two days (as now required by delivery obligations, with certain exceptions). Naked short selling also allows manipulative traders to flood the market with sales of a targeted company's shares which can drive the price of a stock down. Published academic research has shown that stocks with high and/or persistent fails-to-deliver tend to experience depressed stock prices in the form of negative abnormal returns.¹² The rules of supply and demand dictate that if there is a constant supply of short sales without any corresponding limit on the supply, caused by traders short selling "naked" or without any corresponding locate of shares, then the apparent number of trading shares will increase, and the price of the shares will drop. Doing so also allows the naked short seller to cover its short at a profitable price.

21. Naked short selling activity can specifically impact a company and its shareholders by increasing manipulative power for naked short sellers, resulting in a significant decrease in a company's stock price, and by causing corporate governance issues and dilution of a shareholder's governance rights. For shareholders, a depressed share price may cause the company to reduce or eliminate dividend payments, damage retirement savings and pension funds, make it more difficult to use stock portfolio as collateral to secure loans or increase the interest rate charges, or force a borrower to liquidate those or other assets if stock portfolios are used as collateral to avoid defaulting on a loan.¹³

22. Recognizing the pernicious effect that naked short selling has on the marketplace, the SEC has brought enforcement actions against some of the largest brokers in the U.S. and Canada. The following are examples of these enforcement actions:

¹² Stratmann and Welborn, 2016, "Informed short selling, fails-to-deliver, and abnormal returns," *Journal of Empirical Finance* 38.

¹³ Robert Shapiro, *Memorandum on the Impact of a Falling Stock Price on Shareholders* (May 27, 2021), <https://nakedtruth.info/wp-content/uploads/2021/09/How-a-Manipulated-Stock-Affects-a-Company-and-Its-Shareholders-Shapiro-Sonecon-May-27-2021.pdf>.

- (1) In 2023, Citigroup Global Markets Inc. (“Citigroup”) agreed to pay a fine of \$1,500,000 to settle charges by FINRA contending that since at least January 1, 2014, Citigroup violated Regulation SHO and FINRA rules by improperly including securities positions of non-broker-dealer affiliates in two of its aggregation units when calculating the net positions of the aggregation units, and failing to establish, maintain, and enforce, a supervisory system reasonably designed to achieve compliance with Regulation SHO.¹⁴
- (2) In 2020, Morgan Stanley & Co. LLC (“Morgan Stanley”) agreed to pay a \$5,000,000 penalty for Reg SHO violations.¹⁵ Per the SEC, Morgan Stanley hedged synthetic exposure to swaps by purchasing or selling the securities referenced in the swaps, and it separated its hedges into two aggregation units – one holding only long positions, and the other holding only short positions.¹⁶ According to the order, Morgan Stanley was able to sell its hedges on the long swaps and mark them as “long” sales without concern for Reg SHO’s short sale requirements.¹⁷ Morgan Stanley improperly marked certain sell orders in violation of Reg SHO.¹⁸ The Chief of the Complex Financial Instruments Unit of the SEC stated: “For many years, Morgan Stanley has improperly relied on Reg SHO’s aggregation unit exception, resulting in orders being mismarked for countless transactions.”¹⁹
- (3) In 2022, UBS Securities, LLC (“UBS”) was fined \$2.5 million by FINRA for Regulation SHO violations and supervisory failures spanning a period of nine years.²⁰ FINRA found that from 2009 to 2018, UBS failed to timely close out

¹⁴ Financial Industry Regulatory Authority Letter Of Acceptance, Waiver, And Consent, No. 2018057494001, Citigroup Global Markets Inc. to Department of Enforcement Financial Industry Regulatory Authority (December 8, 2022), *available at*: https://www.finra.org/sites/default/files/fda_documents/2018057494001%20Citigroup%20Global%20Markets%20Inc.%20CRD%20%207059%20AWC%20gg%20%282023-1673741994821%29.pdf.

¹⁵ *In the Matter of Morgan Stanley & Co. LLC*, Administrative Proceeding File No. 3-20103, Release No. 90046, September 30, 2020, Order Instituting Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, *available at*: <https://www.sec.gov/files/litigation/admin/2020/34-90046.pdf>; *Morgan Stanley Agrees to Pay \$5 Million for Reg SHO Violations in Prime Brokerage Swaps Business*, September 30, 2020, <https://www.sec.gov/news/press-release/2020-238>.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ Financial Industry Regulatory Authority Letter Of Acceptance, Waiver, And Consent, No. 2018059146501, UBS Securities LLC to Department of Enforcement Financial Industry Regulatory Authority (September 7, 2022), *available at*: <https://www.finra.org/sites/default/files/2022-10/UBS-Securities-AWC-100422.pdf>; *FINRA Fines UBS Securities \$2.5 Million for Regulation SHO Violations and Supervisory Failures*, Ray Pellecchia, October 4, 2022, <https://www.finra.org/media-center/newsreleases/2022/finra-fines-ubs-securities-25-million-regulation-sho-violations#:~:text=WASHINGTON%E2%80%94FINRA%20announced%20today%20that,a%20period%20of%20nine%20years>.

at least 5,300 failure to deliver positions and routed or executed more than 73,000 short sales in securities with an unsatisfied close-out requirement without first borrowing or arranging to borrow the shares.²¹ FINRA also found that from 2009 to August 2022, UBS’s supervisory systems, including its written procedures, were not reasonably designed to achieve compliance with Rule 204 of Regulation SHO.²²

- (4) In 2016, Goldman, Sachs & Co. (“Goldman”) was fined \$15 million by the SEC for allowing short sale locate requests to be handled by an automated model that either would unreasonably grant, in whole or in part, the locates on an automated basis.²³ Goldman employees could (and 98% of the time did) simply by-pass the locate requirements of Regulation SHO by simply hitting “F3” to autolocate the shares—even if they had no reasonable basis for believing the shares were actually located.²⁴ The auto-locates reached more than 20,000 locates (not shares) per day.²⁵ The Director of the SEC’s Enforcement Division stated: “The requirement that firms locate securities before effecting short sales is an important safeguard against illegal short selling... Goldman Sachs failed to meet its obligations by allowing customers to engage in short selling without determining whether the securities could reasonably be borrowed at settlement.”
- (5) In 2023, Goldman was fined \$3,000,000 by FINRA for mismarking short sale orders.²⁶ FINRA contended that from October 2015 to April 2018, Goldman mismarked around 60 million short sale orders, totaling more than 14 billion shares, as long sales, with nearly 8 million of those orders, totaling more than a billion shares, being executed.²⁷
- (6) In 2015, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Merrill Lynch Professional Clearing Corporation (“Merrill Lynch”) were fined \$9 million by the SEC, and were required to pay \$1,566,245.67 in disgorgement and

²¹ *Id.*

²² *Id.*

²³ *In the Matter of Goldman, Sachs & Co.*, Administrative Proceeding File No. 3-17053, Release No. 76899, January 14, 2016, Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, *available at*: <https://www.sec.gov/files/litigation/admin/2016/34-76899.pdf>; *SEC Charges Goldman Sachs With Improper Securities Lending Practices*, January 14, 2016, <https://www.sec.gov/news/press-release/2016-9>.

²⁴ *Id.*

²⁵ *Id.*

²⁶ Financial Industry Regulatory Authority Letter Of Acceptance, Waiver, And Consent, No. 2018059146501 from Goldman Sachs & Co. LLC to Department of Enforcement Financial Industry Regulatory Authority (April 4, 2023), *available at*: https://www.finra.org/sites/default/files/fda_documents/2018059146501%20Goldman%20Sachs%20%26%20Co.%20LLC%20CRD%20361%20AWC%20lp%20%282023-1683246001785%29.pdf.

²⁷ *Id.*

\$334,564.65 in prejudgment interest.²⁸ Merrill Lynch unreasonably relied on “Easy-to-Borrow” lists as a reasonable basis for locating securities even when Merrill Lynch knew such lists were outdated or countervailing factors had changed whether the shares would be easy-to-borrow.²⁹ As such, Merrill Lynch provided millions of locates for short sales without a reasonable basis for believing that the shares would be available for deliver.³⁰ This, in effect, caused its customers’ short sales (as well as Merrill Lynch’s own proprietary trading) to be “naked.”

- (7) Again in 2021, Merrill Lynch, Pierce, Fenner & Smith Incorporated was fined \$850,000.00 for Regulation SHO violations.³¹ FINRA found that from September 2013 until July 2016, Merrill violated Regulation SHO by improperly netting the trading activity of five affiliated broker-dealer customers when determining their close-out obligations and claiming pre-fail credit to eliminate fails to deliver.³² FINRA also found that from January 2005 until January 2015, Merrill violated Regulation SHO by including securities positions held by Merrill’s foreign and non-broker-dealer affiliates when calculating the net positions of two independent trading units.³³
- (8) In 2023, the SEC settled charges against Citadel Securities LLC (“Citadel”) for violating Regulation SHO, the regulatory framework designed to address abusive short selling practices.³⁴ Specifically, Regulation SHO requires broker-dealers to mark sale orders as long, short, or short-exempt.³⁵ Mark Cave, Associate Director of the SEC’s Division of Enforcement said about this

²⁸ *In the Matter of Merrill Lynch, Pierce, Fenner & Smith Incorporated and Merrill Lynch Professional Clearing Corporation*, Administrative Proceeding File No. 3-16567, Release No. 75083, June 1, 2015, Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, *available at*: <https://www.sec.gov/files/litigation/admin/2015/34-75083.pdf> & <https://www.sec.gov/news/press-release/2015-105>.

²⁹ *Id.*

³⁰ *Id.*

³¹ Financial Industry Regulatory Authority Letter of Acceptance, Waiver and Consent No. 2016050801702, Re: Merrill Lynch, Pierce, Fenner, & Smith Inc. (Respondent) (Oct. 6, 2021), *available at*: https://www.finra.org/sites/default/files/fda_documents/2016050801702%20Merrill%20Lynch%2C%20Pierce%2C%20Fenner%20%26%20Smith%20Inc.%20CRD%207691%20AWC%20jlg%20%282021-1636158009040%29.pdf.

³² *Id.*

³³ *Id.*

³⁴ *In the Matter of Citadel Securities, LLC*, Administrative Proceeding File No. 3-21703, Release No. 98482, September 22, 2023, Order Instituting Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, *available at*: <https://www.sec.gov/files/litigation/admin/2023/34-98482.pdf>; *SEC Charges Citadel Securities for Violating Order Marking Requirements of Short Sale Regulations*, September 22, 2023, <https://www.sec.gov/news/press-release/2023-192>.

³⁵ *Id.*

requirement: “Compliance with the order marking requirements of Reg SHO is a key component of regulatory efforts to curtail abusive market practices, including ‘naked’ short selling.”³⁶ The SEC contends that from September 2015 through September 2020 Citadel incorrectly marked millions of orders, marking short sales as long and vice versa.³⁷ Citadel agreed to a cease-and-desist order imposing a censure and a \$7,000,000 penalty.³⁸

d. Recent Decision Concerning Broker Liability

23. In a recent decision issued by Judge Lorna Schofield of the Southern District of New York, entitled *Harrington Global Opportunity Fund, Limited v. CIBC World Markets Corp., et al.*, No. 21 CIV. 761 (LGS), 2023 WL 6316252 (S.D.N.Y. Sept. 28, 2023), the court viewed brokers as gatekeepers of the markets who have an obligation to monitor, surveil, and prevent their customers from engaging in fraudulent trading conduct. The court held that if a broker either knowingly or recklessly ignores the unlawful conduct of their customers, they can be held primarily liable. This decision strips the brokers of the affirmative defense that they are not liable for their customer’s fraudulent conduct.

e. Limited and Incomplete Responses by Brokerage Firms Indicate Potential Regulatory Violations

24. In response to the prior motions, certain Brokerage Firms appear to have coordinated their responses and produced incomplete, non-responsive, illegible, non-ESI documents, thereby necessitating the instant Rule 2004 Motion. The documents produced by the majority of the Brokerage Firms contained only limited positions in Scilex stock, with no explanation of how to interpret this data. The Brokerage Firms were required to produce the data in the aggregate which they failed to provide. No other data responses were provided, including stock loan data.

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

25. Based upon the limited and incomplete information and data that has been produced by the Brokerage Firms and from publicly available data, it appears that restricted shares were either sold (long or short) or lent by the Brokerage Firms and others. Under either circumstance, a violation of SEC Rule 144 and/or Reg SHO may have occurred. Through the Information Requests, material facts will be ascertained that will resolve this issue as a matter of law. Brokerage Firms are primarily liable for the unlawful use of these and any restricted shares. Under no circumstance can restricted shares be used for regular trading or lending purposes. Additionally, an important issue with the production by the Brokerage Firms is that the production is mixing CUSIPs. Some provide data on 808CNT018 (SCLXZZZ—which are the restricted dividend shares), while others provide data on 80880W106 (SCLX—which are the unrestricted common shares). The Brokerage Firms must produce data that specifically delineate between the restricted dividend shares and the unrestricted common shares.

26. Specifically, a review of the information provided by the Brokerage Firms to date showed the following:

- Merrill Lynch, Pierce, Fenner & Smith Incorporated provided their entire stock record, rather than just the customer positions requested, and defined nothing in the record. This makes it impossible to determine what was a position long or short and what is a firm offset account like DTCC, CNS or the Transfer agent account holding the restricted shares.
- Morgan Stanley & Co., LLC provided a document for what appears to be Morgan Stanley & Co.'s participant numbers 50 and 7309, with a summary including a short position total and a stock borrow total, which it claims was to cover the shorts. However, this apparent short and borrow should not be possible as the shares were restricted.
- Morgan Stanley Smith Barney provided a spreadsheet which contained a total of 558,888 shares on March 6, 2023, but their participant entry for that date was for 483,428 shares--which is 75,460 shares less than what their position report states.
- JP Morgan Clearing provided information that revealed it has negative entries that total 2,120,947, but these do not balance with the long of 961,386 shares.

- Interactive Brokers LLC provided positions for restricted and unrestricted, trades for unrestricted and the initial positions from the dividend. The anonymized accounts do not match each different file, as if each was anonymized stand alone and not done a common conversion.

27. Further, the information provided by some Brokerage Firms to date demonstrates that Brokerage Firms were showing short Scilex dividend shares due to failing to receive those shares from some counter party. While some fail-to-receive (“FTR”) positions were documented, no corresponding fail-to-deliver (“FTD”) positions were documented in the original production by Brokerage Firms. The FTRs indicate that Brokerage Firms were lending Sorrento stock over the record date. When Sorrento shares were lent over the record date, Scilex dividend shares could not arrive in the account(s) of the true beneficial owners. The restricted Scilex dividend shares would be delivered to the holder of record on the record date of January 9. Scilex believes the lending of Sorrento shares over the record date created naked short positions of Scilex stock.

28. Both the Debtor and Scilex are interested parties in discovering documents and other information that may lead to establishing liability against the Brokerage Firms and others, thereby realizing a financial recovery for the damages suffered as a result of this unlawful conduct.

29. Scilex verily believes that as a result of the Brokerage Firms’ market manipulation schemes, the value of Debtor’s largest and most valuable asset, Scilex stock, has been damaged. The information requested from Brokerage Firms by this Motion would confirm whether Brokerage Firms possess the Scilex Common Stock, and if not, would demonstrate Brokerage Firms’ participation in illegal market manipulation, resulting in a loss of value of Scilex stock and substantial damage to Scilex, Debtors, and Debtors’ bankruptcy estate. Specifically, Scilex stock lost \$8.38 per share, or about 87% of its value from the Petition Date to the date the stock was sold in the Scilex Transaction. Scilex believes this sale was made into a manipulated market and that

the loss resulted from, and is at least partially attributable to, the Brokerage Firm's naked short selling of Scilex stock.

Relief Requested

30. Scilex seeks entry of an order, substantially in the form attached hereto (the "Proposed Order"), compelling the Brokerage Firms and other third parties to provide written responses to the requests set forth below (collectively, the "Information Requests") on or before November 10, 2023.

31. The Information Requests are intended to provide Scilex with information regarding which Brokerage Firms have failed to report or have underreported the Scilex Common Stock, so that they may seek to remedy such failure, and its effect on the value of Scilex stock and Scilex's ability to operate, in the near term. The Information Requests are as follows:

To Brokerage Firms:

Request 1: State the aggregate number of shares of Scilex Common Stock, reported daily since January 9, 2023 (the "Dividend Record Date"), held by the Brokerage as record owner, beneficial owner, or in any other capacity, each reported separately. As to each customer or client account, state the number of shares of Scilex Common Stock held by the Brokerage, reported daily, by account, on an anonymized basis (referencing each account by a new alpha-numeric name), since the date of the Sorrento Dividend.

Request 2: As to each customer or client account, by account, on an anonymized basis, using the same anonymized alpha-numeric name above state: (1) the number of shares of Scilex Common Stock on the Dividend Record Date, and the number of shares of Dividend Stock such account is eligible to receive (based on pending trades or dividends); and (2) on March 6, 2023 (the "Scilex Shareholder Meeting Record Date"): (a) the number of shares of Dividend Stock held in the account; (b) the total number of shares of Scilex Common Stock held in the account; (c) the number of shares of Dividend Stock that the account is eligible to receive (based on pending dividends); and (d) the number of shares of Scilex Common Stock that the account is eligible to receive (based on pending trades or other dividends).

Request 3: State the aggregate number of shares of Scilex Common Stock, reported separated on a daily basis, traded by or within the Brokerage, (1) on behalf of customers or beneficial owners, and, separately, and (2) as principal, for the

Brokerage's own account, or otherwise, between the Dividend Record Date and the present.

Request 4: As to each customer or client account, on an anonymized basis, using the same alpha-numeric name above, state the number of shares of Scilex Common Stock purchased on or after the Record Date.

Request 5: As to each such customer or client account, on an anonymized basis, using the same alpha-numeric name above, (1) state whether the account is part of a stock loan program or whose shares are otherwise eligible to enter into stock loan transactions, and (2) state the number of shares of Scilex Common Stock loaned attributed to such account on a daily basis from the Record Date to the present.

Request 6: Order and Trade data: Should include, but not be limited to records reflecting the original order and subsequent changes and/or trade executions with all the required information (ie: sell short, agency/principal, Solicited/unsolicited, all timestamps, etc.)

Request 7: Stock Locate records: Should include, but not be limited to records reflecting the stock locates provided by the stock loan desk on short sales and the required documents reflecting the locate requested by the trade originator. These records should include the time of entry and in the case of locates, the expiration time of the availability of the stock to be borrowed.

Request 8: Affirmative Determination records: Should include, but not be limited to records reflecting affirmative determination as to the location of the stock being sold as required in a long sale.

Request 9: Stock Record: Should include, but not be limited to records reflecting the daily positions and control locations of all accounts within the firm (i.e. firm, control, operations, customer, fail, suspense accounts etc.). These records would reflect the full daily two-sided debit/credit balancing of the stock.

Request 10: Stock Record Debit/Credit Journals: Should include, but not be limited to journal records reflecting both the debit and credit non-trade movements of cash and securities between stock record accounts. These records should reflect both the debit and credit sides in a single offsetting entry.

Request 11: Stock Loan/Borrow records: Should include, but not be limited to records that reflect the borrowing and lending of securities, including the borrow/lend rate, the date of the loan or borrow and the closeout date. These records should also include any and all records that source the borrow or loans back to customer accounts or other source accounts with a full accounting of the stock movements.

Request 12: Easy to Borrow/Hard to Borrow records: Should include, but not be limited to the daily list generally created by Stock Loan Departments reflecting

stocks that were either easy to borrow or hard to borrow. This could potentially be two separate lists depending on firm procedures.

Request 13: Produce all records evidencing loans and borrows by and to Brokerage Firms in Sorrento stock (SRNEQ) over the record date of January 9, 2023.

To the DTCC:

Request 1: CNS Accounting Summary: Records reflecting daily fail to deliver and fail to receive positions by participant (broker).

Request 2: Consolidated Trade Summary: Records reflecting daily bought and sold share totals for each exchange by participant(broker).

Request 3: Correspondent Clearing Data: Records reflecting daily bought and sold transactions between for each exchange by and between participants(brokers) utilizing the Correspondent Clearing system to transfer shares and money between participants(brokers).

Request 4: DTCC Participant Daily Activity Statement: Records reflecting all movements and activities of shares and money by and between participants(brokers) at DTCC.

To FINRA:

Request 1: FINRA CAT Data: Consolidated Audit Trail (“CAT”) data records reflecting the lifespan transactions of orders from origination to completion capturing all relevant information (i.e. broker info, customer info, long or short indicators, unique ID etc.), with precision timestamps. These records will also reflect but are not limited to cancel/replaces, order forwarding, executions, and expired orders etc.

Request 2: Short Interest Data (Broker Level): Records reflecting the total short interest shares reported to FINRA, twice a month, with broker level detail.

Basis for Relief

32. Bankruptcy Rule 2004(b) provides that, upon the motion of any party in interest, this Court may order the examination of any person relative to (a) the acts, conduct, property, liabilities or financial condition of the Debtors, (b) any matter that may affect the administration of the Debtors’ estates, (c) the operation of the Debtors’ businesses and the desirability of its continuance, (d) the source of money or property acquired or to be acquired for the purpose of

consummating a plan of reorganization and the consideration given or offered therefor, and (e) any other matter relevant to the case or to the formulation of a plan of reorganization. *See* Fed. R. Bank. P. 2004.

33. Under Section 105 of the Bankruptcy Code, the Court possesses broad equitable powers to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the Bankruptcy Code. In a reorganization case under chapter 11 of the Bankruptcy Code, Rule 2004 authorizes this Court, on motion of any party in interest, to order the examination of “any . . . matter relevant to the case or to the formulation of a plan.” Fed. R. Bankr. P. 2004(b). The scope of a Rule 2004 examination is “unfettered and broad.” *In re Washington Mut., Inc.*, 408 B.R. 45, 49 (Bankr. D. Del. 2009); *see also In re Drexel Burnham Lambert Group, Inc.*, 123 B.R. 702, 711 (Bankr. S.D.N.Y. 1991) (noting Rule 2004 examinations may be “very broad”). “Legitimate goals of Rule 2004 examinations include discovering assets, examining transactions, and determining whether wrongdoing has occurred.” *Washington Mut., Inc.*, 408 B.R. at 50 (citation omitted). “Potential examinees include third parties that possess knowledge of the debtor’s acts, conduct, liabilities or financial condition which relate to the administration of the bankruptcy estate.” *In re DeWitt*, 608 B.R. 794, 797 (Bankr. W. D. Pa. 2019) (citation omitted). It is well established that a debtor may take a Rule 2004 examination of third parties. *See, e.g., In re Fearn*, 96 B.R. 135, 138 (Bankr. S.D. Ohio 1989) (noting that Rule 2004 “may properly extend to creditors and third parties who have had dealings with the debtor”); *see also In re Recoton Corp.*, 307 B.R. 751, 755 (Bankr. S.D.N.Y. 2004) (“Any third party who has a relationship with a debtor may be made subject to a Rule 2004 investigation.”).

34. Federal Rule of Bankruptcy Procedure 2004(c) provides that compliance may be compelled through Federal Rule of Bankruptcy Procedure 9016, which allows issuance of a

subpoena under Federal Rule of Civil Procedure 45 and a subpoena compelling a deposition through written examination may be issued under Federal Rule of Civil Procedure 45. *See* Fed. R. Bank. Pro. 2004, 9016; Fed. R. Civil Pro. 31, 45. At a hearing in these cases held on March 29, 2023, the Court expressed a willingness to permit the Debtors to request written responses from the Brokerage Firms with respect to requests relating to the shares of Scilex Common Stock, which will be a much more efficient process than seeking oral examination and/or the production of documents relating to the topics of the Information Requests.

35. Scilex's requests fall squarely within the scope of a Bankruptcy Rule 2004 examination, are fully consistent with the Court's authority under section 105(a) of the Bankruptcy Code, and are supported by the foregoing authorities:

a. Sorrento's most significant asset is its majority of the common shares in Scilex. The value of the shares of Scilex Common Stock and Scilex Preferred Stock is intertwined with the ability of Scilex to govern itself and operate as a legal entity. Thus, information regarding the impediments to that governance relates to "property . . . of the Debtors."

b. Further, to the extent Sorrento may seek to monetize its shares of Scilex Common Stock and/or Scilex Preferred Stock, either through a sale pursuant to section 363 of the Bankruptcy Code or through a plan of reorganization, information bearing on the potential depression of the value of Scilex Common Stock resulting from not knowing who owns and can vote a substantial number of shares of such stock, certainly constitutes a "matter that may affect the administration of the Debtors' estates," relates to a "source of money or property acquired or to be acquired for the purpose of consummating a plan of reorganization and the consideration given or offered therefor," and is "relevant to the case or to the formulation of a plan of reorganization."

c. Moreover, due to the restriction prohibiting the actual transfer by Sorrento shareholders of the Dividend Stock, the Brokerage Firms should still retain such shares within their platform. Their failure to report such shares to Broadridge may result in a failure to deliver proxy materials to Scilex shareholders in violation of federal securities laws and applicable regulations that require the delivery of such proxy materials. The information requested herein thus assists the goal of “determining whether any wrongdoing has occurred.”

d. Finally, each Brokerage Firm that has received at least 500,000 shares of Scilex Common Stock pursuant to the Sorrento Dividend, have a pre-existing relationship with Sorrento, given that they are the custodians for shareholders of Sorrento and, in that capacity, received the Dividend Stock that has remained un-reported or under-reported.

36. For the foregoing reasons, Scilex requests that this Court (a) enter the Proposed Order compelling written responses to the Information Requests from the Brokerage Firms, without prejudice to Scilex’s rights to seek further and other forms of discovery from the Brokerage Firms, and (b) grant such other and further relief as this Court deems just and proper under the circumstances.

Emergency Consideration

37. The Debtor’s bankruptcy exit plan is to be confirmed on or about November 20, 2023. Therefore, Scilex respectfully requests emergency consideration of this Motion on or before November 10, 2023. Recovery of the value inherent in the shares that have been requested to be produced will directly impact the value of the Debtor’s estate. Scilex is funding all expenses and costs associated with this Motion, and therefore, the Debtor’s estate will not be responsible or burdened with funding this undertaking.

Notice

38. Scilex will provide notice of this Motion to the following parties or their respective counsel: (a) the U.S. Trustee; (b) counsel to the Unsecured Creditors' Committee; (c) counsel to the Ad Hoc Equity Committee; (d) the Office of the United States Attorney for the Southern District of Texas; (e) the state attorney generals for states in which the Debtors conduct business; (f) the Internal Revenue Services; (g) the Securities and Exchange Commission; (h) the Environmental Protection Agency; (i) other governmental agencies having a regulatory or statutory interest in these cases; (j) the Brokerage Firms; and (k) any party that has requested notice pursuant to Bankruptcy Rule 2002. In light of the nature of the relief requested, no other or further notice need be given.

Scilex respectfully requests that the Court enter the Proposed Order granting the relief requested in this Motion and such other and further relief as may be just and proper.

Dated: October 27, 2023

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Certificate of Accuracy

I certify that the foregoing statements are true and accurate to the best of my knowledge. This statement is being made pursuant to Bankruptcy Local Rule 9013-1(i).

/s/ James Wes Christian

James W. Christian

Certificate of Service

I certify that on October 27, 2023, I caused a copy of the foregoing document to be served by the Electronic Case Filing System for the United States Bankruptcy Court for the Southern District of Texas.

/s/ James Wes Christian

James W. Christian