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Broker Slams SEC's 3rd Circ. Appeal In Penny Stock Case

By **Jeannie O'Sullivan**

Law360 (June 15, 2018, 3:48 PM EDT) -- A broker-dealer has slammed the U.S. Securities and Exchange Commission's bid at the Third Circuit to overturn the dismissal of its civil case over an alleged $17.2 million pump-and-dump penny stock scheme, arguing that the agency pushed for punitive damages too late.

A New Jersey federal judge properly shut down the SEC's injunctive relief bid stemming from Guy Gentile's alleged schemes after finding it was punitive in nature and therefore subject to the five-year statute of limitations for civil penalties set by the U.S. Supreme Court's decision in Kokesh v. SEC, Gentile argued in a reply brief filed on Thursday in the federal appeals court. The agency's 2016 action sought an "obey the law" order and to bar Gentile from trading penny stocks, based on the broker-dealer's purported conduct from 2007 and 2008.

The SEC argued in its appeal brief that U.S. District Judge Jose L. Linares "misunderstood" the nature of injunctive relief in holding that injunctions are penalties in **his December opinion**. The agency invoked the Third Circuit's 2013 ruling in United States v. EME Homer City Generation LP, which held that even when the SEC can't seek civil monetary penalties under the statute of limitations, it can still get injunctive relief requiring compliance with the law.

However, Gentile — who was accused along with co-conspirators of using misleading promotional materials to inflate prices of free-trading shares in Raven Gold Corp. and Kentucky USA Energy Inc. — contends that nothing in Judge Linares' opinion was contrary to relevant case precedent.

"Rather, Judge Linares held that the SEC had pled itself out of court in this specific case because the face of the amended complaint made clear that the claims were all brought after five years, and that the relief sought by the SEC did not serve any identifiable remedial purpose but rather was solely intended to punish Gentile for alleged conduct from a decade ago, and thus was time-barred by [federal securities law's] five-year limitation period," Gentile's reply brief said.

The appeal hinges on whether Congress intended the words "or otherwise" in the statute of limitations provision of securities law — codified as Section 2462 — to mean nonpecuniary penalties such as injunctions and industry bars, Gentile said in his brief. The provision says that no action "for the enforcement of any civil fine, penalty or forfeiture, pecuniary or otherwise" can be entertained by a court unless it is filed within five years from the date the claim accrues, according to the brief.

The SEC "has failed to come to grips with the current state of the law" in arguing that the appeals court should ignore the ruling in Kokesh and find that an injunction is remedial and not punitive, the reply brief says.

The SEC wants the case remanded for further findings per the Third Circuit's 1980 ruling in SEC v. Bonastia, holding that "whether to enjoin a defendant from future violations requires a fact-intensive inquiry into the violations and the defendant's circumstances," the agency said in its appeal, which expressed concerns about Gentile's alleged plans to expand his online brokerage firm.

However, the Bonastia test is used to determine the appropriateness of an injunction "only after the finding of liability," not to resolve whether or not requested relief constitutes a penalty, Gentile countered in his reply.

Prosecutors have said that after obtaining control over large blocks of the free-trading shares of the two companies, Gentile and his co-conspirators allegedly inflated their prices by engaging in manipulative trading and disseminating misleading promotional materials touting the stocks and encouraging others to purchase them.

Gentile and his co-conspirators ultimately sold large volumes of the stock to investors, netting about $17.2 million in gross trading proceeds, prosecutors said. Victims of the scheme suffered losses when the companies' stock prices dropped, they said.

Prior to dismissing the SEC's civil case, Judge Linares also cited the five-year statute of limitations when he granted Gentile's motion to dismiss his March 2016 criminal indictment stemming from the alleged scheme.

The judge found that the alleged misconduct ended in June 2008, giving the SEC until 2013 to file charges. If waivers executed by Gentile to toll the limitations period were considered valid, the indictment would have had to be filed by June 2015, the judge said.

A representative for the SEC didn't immediately respond to request for comment on Friday. A representative for Gentile was not immediately available to comment.

The SEC is represented in-house by Nancy A. Brown, Sarah Prins and Daniel Staroselsky.

Gentile is represented by Adam C. Ford of Ford O'Brien LLP.

The case is SEC v. Guy Gentile, case number 18-1242, in the U.S. Court of Appeals for the Third Circuit.

--Editing by Stephen Berg.
