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SEC Filed $17M Stock Scheme Suit Too Late, NJ Judge Says

By **Jeannie O'Sullivan**

Law360, New York (December 13, 2017, 8:59 PM EST) -- A New Jersey federal judge on Wednesday tossed the U.S. Securities and Exchange Commission's civil case against a broker-dealer in an alleged $17.2 million pump-and-dump penny stock scheme, ruling that the agency's case came too late for punitive actions.

U.S. District Judge Jose Linares, who previously dismissed criminal charges stemming from Guy Gentile's alleged schemes, granted his dismissal motion after agreeing that the injunctive relief the SEC sought in its March 2016 action asking for an "obey-the-law" order and barring him from trading penny stocks 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.

The alleged scheme, in which Gentile 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., ceased in 2008, meaning the SEC would have had to file its case by 2013.

The decision on the civil action hinged on whether or not the relief sought by the SEC was punitive in nature, according to Judge Linares. The "obey-the-law" order the agency wanted would simply require Gentile to abide by federal laws and regulations relating to securities, but would also stigmatize him and wouldn't compensate any victims, the judge reasoned.

"Hence, the only person who would be impacted by such an order would be defendant, and the only purpose for such an order would be to penalize him for his alleged involvement in the [Raven Gold Corp. and Kentucky USA Energy Inc.] schemes," the opinion said.

Likewise, the penny stock ban sought by the SEC "would only serve to punish" Gentile, Judge Linares said.

"The order would not restore any 'status quo ante' nor would it serve any retributive purposes. Rather, it would merely restrict defendant's business structure and methodology, in perpetuity, simply because he was alleged to have violated securities laws when he purportedly was involved in the [Raven Gold Corp. and Kentucky USA Energy Inc.] schemes," the judge said.

An attorney for Gentile, Adam C. Ford of Ford O'Brien LLP, said it would be interesting to see if prosecutors appealed the decision.

"While I am very pleased with judge Linares' ruling, I am equally surprised that the SEC continued to prosecute this case following Kokesh, when the Supreme Court clearly announced that any sanctions sought to penalize past conduct are 'penalties' subject to a strict limitations period," he said. "The SEC should have withdrawn its entire case at that time rather than forcing Mr. Gentile to continue to defend himself to this obvious conclusion."

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.

Judge Linares had cited the five-year statute of limitations in January when he granted Gentile's motion to dismiss his March 2016 indictment on securities fraud charges.

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.

Representatives for the SEC didn't immediately respond to request for comment.

The SEC is represented in-house by Nancy A. Brown, Elizabeth A. Butler, Andrew M. Calamari, Simona K. Suh and Thomas P. Smith Jr.

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

The case is SEC v. Gentile, case number 2:16-cv-01619, in the U.S. District Court for the District of New Jersey.

--Additional reporting by William Gorta. Editing by Adam LoBelia.