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# Federal Court Holds Neither *Janus*, Nor Statute of Limitations Shields Alleged "Pump-And-Dump" Fraudsters From Civil Liability in SEC Case

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In another example of the limits to which defendants may successfully rely on the Supreme Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), earlier this summer, District Judge Leigh Martin May refused to dismiss an SEC enforcement action against the alleged perpetrators of a "pump-and-dump" scheme. *See SEC v. Strebinger*, No. 1:14-CV-03533-LMM, 2015 WL 4307398 (N.D. Ga. June 11, 2015). The court also rejected the defendants' statute of limitations defense. For both issues, the court's order offers useful insights, particularly for securities practitioners in the Eleventh Circuit. **Background**

In November 2014, the SEC filed this enforcement action against two individuals and a financial institution for allegedly carrying out a "pump-and-dump" scheme that netted the defendants millions of dollars in profits. The SEC accused the defendants of, beginning in 2009, acquiring the so-

called “penny” stock of a shell public company. Although the defendants acquired more than five percent of the company’s stock, they never filed Schedule 13D reports with the SEC disclosing their ownership stakes. According to the complaint, the defendants then arranged a reverse merger between the shell company and an oil and gas business. In connection with that transaction, the defendants hired third parties to write reports touting the value of the shell company’s stock. The defendants were heavily involved in the drafting of the reports and, in turn, arranged for and funded their distribution to potential investors. According to the SEC’s action, those reports contained materially false and misleading statements in that the reports did not disclose the defendants’ ownership interests in the shell company, nor did the reports inform readers that the defendants were marketing and funding the promotion of the shell company’s stock. The reports were disseminated to possible investors from September 2009 through April 2010. During the marketing campaign, the shell company’s stock price rose significantly, which allegedly permitted the defendants to sell their shares through offshore accounts and reap millions in profits. When the defendants ceased their promotional efforts and sold their shares, the stock price dropped, and by December 2011, the shell company’s stock was worthless with the company in bankruptcy. The SEC asserted several causes of action, including fraud claims pursuant to both Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5. The defendants moved to dismiss, arguing, among other things, that the SEC failed to state a claim and that the action was barred by the five-year statute of limitations. **The Court Refuses to Apply *Janus* to Dismiss the Fraud Claims**

In their motion, the defendants contended that *Janus* mandated dismissal of the SEC’s fraud claims. In *Janus*, the Supreme Court held that for purposes of Rule 10b-5(b), which prohibits the making of any untrue statement of a material fact in connection with the purchase or sale of securities, the “maker” of such a statement must have “ultimate authority” over that statement, “including its content and whether and how to communicate it.” 131 S. Ct. at 2302. Accordingly, an investment adviser and parent company could not be liable for false statements otherwise “made” by an investment fund in its prospectuses. *Id.* at 2305. In *Strebinger*, the defendants sought to capitalize on *Janus* by arguing that any misstatements were made by the third parties who wrote the promotional materials. Judge May rejected that defense and explained that *Janus* solely interpreted Rule
10b-5(b). Because the SEC had charged the defendants in *Strebinger* under Rule
10b-5(a), which prohibits individuals from employing any “device, scheme, or artifice to defraud,” and Rule 10b-5(c), which penalizes individuals who engage in “any act, practice, or course of business” that would operate as a fraud in connection with the purchase or sale of a security, *Janus* was of no help to the defendants, given their alleged perpetration of the “pump-and-dump” scheme. 2015 WL 4307398, at *7-8. As for the fraud claims under Section 17(a) of the Securities Act, Judge May’s analysis cited and tracked the Eleventh Circuit’s reasoning in *SEC v. Big Apple Consulting USA, Inc.*, 783 F.3d 786 (11th Cir. 2015). *Id.* at *8-9. As this firm has reported previously, in *Big Apple*, the court refused to expand *Janus* to limit claims under Section 17(a) of the Securities Act. In *Big Apple*, the Eleventh Circuit observed that, while Rule 10b-5(b)’s text includes the word “make,” two of Section

17(a)'s three subsections do not. 783 F.3d at 796. As for the remaining subsection – Section 17(a)(2) – which bars a person from obtaining money in the offer or sale of securities by means of any untrue statement of a material fact, the Eleventh Circuit held that that provision addresses a broader range of conduct than "making" such a statement, and thus, the rule in *Janus* did not apply. *Id.* at 797-98. Like the Eleventh Circuit's opinion in *Big Apple*, Judge May's order in *Strebinger* illustrates the limitations on a defendant's use of *Janus*, especially where the fraud claims rest on anything other than Rule 10b-5(b). Defendants facing claims for which *Janus* might be held inapplicable, such as where a scheme theory of liability has been alleged, should consider alternative arguments for dismissal. **The Court Rejects the Statute of Limitations Defense**

In some cases, one such alternative could be a statute of limitations defense. That was not the case in *Strebinger*, however, where Judge May made quick work of the defendants' assertion that the five-year statute of limitations in 28 U.S.C. § 2462 barred the SEC's claims. The defendants argued that the SEC's claims rested on individual acts, including their initial acquisition of the shell company's stock and their commissioning of the promotional reports, all of which occurred more than five years before the SEC filed suit. *Strebinger*, 2015 WL 4307398, at *4. The court rejected that argument and explained that the SEC's claims were "based on one *continuous* fraudulent scheme that encompasses several individual acts . . . ." *Id.* (emphasis in original). Under the "continuing violations doctrine," which tolls the statute where the violation underlying the claim continues to occur within the limitations period, the SEC's action – premised as it was on an ongoing "pump-and-dump" scheme that did not conclude until the defendants sold their stock in April 2010 – was not foreclosed. **Conclusion**

Securities practitioners should glean two important takeaways from *Strebinger*. First, *Janus* may not be the silver bullet that many had hoped for, especially where defendants face fraud claims under Section 17(a) of the Securities Act or under Rule 10b-5(a) or (c) promulgated pursuant to Section 10(b) of the Exchange Act. Second, given that many securities fraud claims are alleged to have occurred over extended periods of time, a promising statute of limitations defense may fall prey to the "continuing violations doctrine." *SEC v. Strebinger*, No. 1:14-CV-03533-LMM, 2015 WL 4307398 (N.D. Ga. June 11, 2015)

## Related Practices

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