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SEC's Naked Short-Selling Suit Against NJ Firm To Continue

By **Katryna Perera**

Law360 (March 19, 2024, 8:15 PM EDT) -- A New Jersey federal judge has ruled the U.S. Securities and Exchange Commission can largely proceed with its case against a trader and his firm accused of reaping $2 million from an illegal short-selling scheme, but said it cannot seek civil penalties for alleged trading that occurred in three securities.

U.S. District Judge Renée Marie Bumb on Monday refused to toss any of the claims in the SEC's suit against Sabby Management LLC and its managing partner, Hal D. Mintz.

But she agreed with the defendants that the SEC's claims for short sales that occurred before Nov. 22, 2017, asserted under the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940, are time-barred, and therefore the SEC cannot seek civil penalties on those trades.

"Though the SEC urges the court to deny defendants' argument without prejudice and to evaluate remedies after liability is determined, ... the SEC's argument is hardly a full-throated opposition," the judge **said in the opinion**. "As the answer is clear on the face of the complaint, the court should resolve the question at the pleading stage."

The judge said the SEC can still seek disgorgement on the trades, though, since scienter-based claims for disgorgement are subject to a 10-year statute of limitations.

The SEC's complaint, filed last June, contends Sabby and Mintz committed fraud by engaging in "naked short selling" campaigns against 10 public companies.

While short-selling is a legal practice of selling borrowed securities with the goal of later buying the same securities at a lower price before they need to be delivered, Sabby did not follow these steps, the SEC said.

Instead, the short sales at issue were "naked" because the firm placed the sales without having first borrowed or located the shares, and then failing to make timely delivery of them, the SEC said.

Sabby and Mintz have pushed back against the SEC's case on a number of grounds. Among other things, they argued in their **dismissal motion** that the SEC failed to identify any misstatements or a fraudulent scheme, failed to properly allege scienter and engaged in improper group pleading. Judge Bumb rejected all of these arguments.

First, she said the complaint and an accompanying appendix contain all the necessary facts to adequately plead a fraudulent scheme, and false and misleading statements made by the defendants.

Second, the SEC adequately pled that the defendants knowingly or recklessly engaged in the alleged fraud, the judge said.

"No reasonable reading of the complaint could generate doubt about defendants' alleged motive here: avoiding the costs associated with applicable regulatory requirements to earn defendants higher (illicit) profits," the judge said. "Similarly, defendants' opportunity to mismark sale orders and lie to executing broker-dealers about the number of 'locates' they had obtained and to profit accordingly is obvious, and defendants do not argue otherwise."

Finally, Judge Bumb disagreed with the defendants' assertion that the suit was ripe with group pleading.

"As the only actor, Mintz is alleged to be at the center of the scheme, and Sabby is alleged to be liable for Mintz's conduct because Mintz acted in furtherance of the fraud on the entity's behalf," she said. "It is thus clear what Mintz's role was in the alleged fraud. Courts typically reject the impermissible-group-pleading argument where, as here, a defendant's role in an alleged fraud is readily discernable from the pleading."

In a phone call with Law360 on Tuesday, Jay Auslander of Wilk Auslander LLP, counsel for the defendants, said they were pleased the court dismissed the time-barred claims for penalties. He also noted the judge struck the SEC's reference to Sabby as a "recidivist."

"We viewed that characterization as not only offensive but just plain wrong," Auslander said.

According to a footnote in the Monday opinion, the SEC had labeled Sabby as a recidivist in connection with identifying the firm's past Regulation M violations. The judge said this label "impugns Mintz's reputation" and is inappropriate, and struck the reference.

The SEC declined to comment Tuesday.

The SEC is represented in-house by Daniel J. Maher and Edward J. Reilly.

Sabby and Mintz are represented by Jay S. Auslander, Aari Itzkowitz and Michael Van Riper of Wilk Auslander LLP.

The case is Securities and Exchange Commission v. Mintz, case number 1:23-cv-03201, in the U.S. District Court for the District of New Jersey.

--Editing by Lakshna Mehta.