UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO. 16-cv-21301-DPG

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

ARIEL QUIROS,
WILLIAM STENGER,
JAY PEAK, INC.,
Q RESORTS, INC.,
JAY PEAK HOTEL SUITES L.P.,
JAY PEAK HOTEL SUITES PHASE II L.P.,
JAY PEAK MANAGEMENT, INC.,
JAY PEAK PENTHOUSE SUITES L.P.,
JAY PEAK GP SERVICES, INC.,
JAY PEAK GOLF AND MOUNTAIN SUITES L.P.,
JAY PEAK GP SERVICES GOLF, INC.,
JAY PEAK LODGE AND TOWNHOUSES L.P.,
JAY PEAK GP SERVICES LODGE, INC.,
JAY PEAK HOTEL SUITES STATESIDE L.P.,
JAY PEAK GP SERVICES STATESIDE, INC.,
JAY PEAK BIOMEDICAL RESEARCH PARK
L.P.,
AnC BIO VERMONT GP SERVICES, LLC,

Defendants, and

JAY CONSTRUCTION MANAGEMENT, INC.,
GSI OF DADE COUNTY, INC.,
NORTH EAST CONTRACT SERVICES, INC.,
Q BURKE MOUNTAIN RESORT, LLC,

Relief Defendants.
____/

DEFENDANT ARIEL QUIROS'S REPLY
IN SUPPORT OF MOTION TO DISMISS THE AMENDED COMPLAINT

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I. INTRODUCTION

The SEC claims that Mr. Quiros's Motion to Dismiss ("Motion") is "meritless" and that "[n]one of Quiros' arguments are supported by the case law he cites." But the SEC's bluster reveals only its insecurity. After a three-year investigation, it has brought claims in a high-profile case that disregard established precedent and should be dismissed. The SEC's Opposition attempts to avoid the fatal problems with its Amended Complaint ("FAC") through lengthy, repetitive, and irrelevant summaries of its allegations and "straw man" arguments that fail to address the more difficult, carefully reasoned questions Mr. Quiros's Motion actually raised.[1]

First, the SEC denies that the 5-year statute of limitations of 28 U.S.C. § 2462 bars any of its claims for monetary relief. In an attempt to avoid Section 2462, the SEC offers a 4-step argument:

1. *SEC v. Graham*, 823 F.3d 1357 (11th Cir. 2016) and Section 2462 only limit claims seeking disgorgement, and not injunctions.
2. Claims by the SEC only accrue when a defendant receives ill-gotten gains.
3. **BUT**, the SEC does not need to plead:
   a. when Mr. Quiros received ill-gotten gains; or, even,
   b. whether the SEC seeks disgorgement or injunctive relief for any claim.
4. Therefore, none of the SEC's claims can be dismissed.

The SEC thereby contends that it can render both *Graham* and Section 2462 nullities through selective pleading. As to Step 1, there is no disagreement: the Motion conspicuously acknowledged that *Graham* does not apply to injunctions.[2] But Step 2 is not the law: securities claims accrue, by statute, upon a fraudulent offering. The SEC cites no authority holding that, if a claim seeks disgorgement as a remedy, the claim only accrues when a defendant receives ill-gotten gains. And, in any event, despite claiming in Step 3 that it need not plead *when* Mr. Quiros received ill-gotten gains, the FAC's factual allegations unavoidably concede that any alleged "ill-gotten gains" in this case occurred *at the time of the offerings*, when defendants allegedly acquired investor money through fraud.

Furthermore, Step 3 is an admission of "puzzle pleading," *i.e.*, using "cross-references and repetition" in lieu of real substance. The FAC connects no specific factual allegation to any of its 52 Counts, and then mentions none of the 52 Counts in the Relief Requested. It is impossible to know (i) which facts, and (ii) what relief, pertain to each Count. This problem is best illustrated by the SEC's

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[1] Mr. Quiros's brief was 20-pages long prior to filing. In the filing process, a macro appears to have been run on the document that enlarged the margins. Because of this enlargement, the memorandum, as filed, was 21 pages instead of 20 pages. The macro also appears to have altered the pagination, so that the first page of the memorandum is page 3 and not page 1. We apologize for the mistake.

[2] Contrary to the Opposition, Mr. Quiros **did not argue** that *Graham* applied to claims to the extent they seek injunctive relief. (*Compare* Opp. at 3 (Quiros' [sic] motion glosses over . . . that *Graham* held Section 2462 has no applicability to . . . injunctive relief) *with* Motion at 3 and 12 (*Graham* "concluded that Section 2462 did not apply to injunctions").

claims that Mr. Quiros usurped more than $21.9 million to purchase a ski resort – which amounts to *almost half of the total $55 million alleged ill-gotten gains in this case*. (FAC ¶¶ 57-69.) The purchase of the resort with ill-gotten gains allegedly occurred from June 17-23, **2008** (*id.* at ¶¶ 67-68), thus any claimed ill-gotten gains would have been in or before 2008 – *i.e.* eight years ago. *Graham* and Section 2462 clearly bar such claims to the extent they seek disgorgement. But the SEC conveniently neglects to connect its central factual allegation to any of its 52 Counts. Even worse, the SEC fails to say what relief (injunctive, disgorgement, both, etc.) it seeks for *any* of the 52 Counts, including Counts 1-29, which would be clearly barred to the extent the SEC intends to seek disgorgement.[3] The Court should reject the SEC's deliberately obfuscatory pleading.

Further, the Opposition fails to address a fundamental problem cited in the Motion: securities fraud requires *misrepresentations* or *omissions* **prior** to the offering of securities, but the SEC has alleged only *conduct* occurring **after** the offerings. The SEC has thereby failed as a matter of law, and indeed logic, to allege either fraud or fraudulent conduct. Similarly, the SEC has not pled facts that Mr. Quiros participated in making or had "ultimate authority" over offering documents.[4] The SEC has not even pled that Mr. Quiros *read* any offering documents prior to the offerings.

Finally, Mr. Quiros requests that the Court strike "Permanent Injunctive Relief," Section **B** of the Relief Requested, as an "obey-the-law" injunction. The SEC calls this request "meritless," but misleadingly uses allegations solely from Section **C** of the Relief Requested to support its argument.

II. THE STATUTE OF LIMITATIONS BARS MOST OF THE SEC'S CLAIMS

A. The Court Should Dismiss Claims That Arise From Time-Barred Transactions

The SEC misstates the basis for the Motion regarding the statute of limitations, which is that Section 2462 and *Graham* preclude the SEC's *disgorgement* claims to the extent that they accrued five or more years before the filing of the Complaint. While the SEC is correct that *Graham* does not reach its claims for injunctive relief (which was never disputed), that is entirely beside the point.

The Court can and should dismiss any time-barred claims or parts of claims. *Wiand v. Sarasota*

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[3] Contrary to the Opposition, Mr. Quiros **did not argue** that the SEC had to plead the *amount* of disgorgement sought. (*Compare* Opp. at 3-4 (citing and discussing seven cases that hold that the SEC does not have to plead the *amount* of disgorgement) *with* Motion at 13-14 (arguing that the SEC must simply plead what remedy or remedies it seeks for each Count).) The SEC must allege whether it seeks disgorgement, an injunction, and/or some other relief for each Count.

[4] Contrary to the Opposition, Mr. Quiros **did not argue** that he could only be liable if he personally made misrepresentations. (*Compare* Opp. at 2 ("Neither statute requires Quiros to have *personally* made a misrepresentation or omission to be liable") *with* Motion at 15-16 (noting that the law requires either that Mr. Quiros "participate in making" or have "ultimate authority" for intentionally misleading statements "in direct connection to the purchase and/or sale of securities.").)

Opera Ass'n, 2011 U.S. Dist. LEXIS 109166 at *17-18 (M.D. Fla. July 11, 2011). In *Wiand*, a receiver appointed pursuant to an SEC enforcement action brought claims for actual and constructive fraud and unjust enrichment to recover losses from alleged Ponzi scheme transactions that occurred over time. *Id*. The court found that the statute of limitations barred the constructive fraud and unjust enrichment claims as to two of the 12 allegedly improper transactions and recommended dismissal of the parts of those claims that concerned the two transactions, while leaving the rest of the complaint intact. *Wiand* applied a transactional test for the statute of limitations – the statute barred transactions outside the limitations period. *Id*. at *21. While *Wiand* concerned ordinary limitations periods for underlying causes of action, whereas *Graham* concerns a special limitations period that applies to SEC actions regarding securities transactions, the analysis is the same: when a complaint alleges multiple transactions – some time-barred, some not – a court can and should dismiss the claims that are barred.

B. <u>The Date Of The Offerings Governs When The Claims Accrue</u>

The SEC does not bring *claims* for disgorgement; disgorgement is a *remedy*. Contrary to the SEC's attempt to re-characterize its claims in its Opposition, the SEC alleges *securities fraud* – "misrepresentations and omissions" (FAC ¶¶ 96, 116) – regarding seven offerings.[5] Such claims first accrue "when [a defendant] first offered and sold" securities. *SEC v. U.S. Funding Corp.*, 2006 U.S. Dist. LEXIS 24789, at *25 (D. N.J. April 11, 2006); *see also*, *Adams v. Cavanagh Communities Corp.*, 847 F. Supp. 1390, 1402 (N.D. Ill. 1994) (under Section 10(b), the "limitations period for a securities action begins to run with the purchase or sale of a security."). The SEC has not cited to any authority, and we have been unable to find any, supporting the SEC's suggestion (Opp. at 8) that its claims accrue only upon the "receipt of ill-gotten gains," or even that such receipt is an element of the SEC's claims.[6]

The SEC's own allegations contradict its proposed accrual rule. The FAC repeatedly says that its claims against Mr. Quiros arise from securities offerings,[7] and each of the first 29 Counts listed at the

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[5] Therefore, contrary to the Opposition (Opp. at 3-9), Rule 9, not Rule 8, controls the entire FAC.

[6] *SEC v. Merchant Capital, LLC*, 483 F.3d 747, 766 (11th Cir. 2007) (citing to Supreme Court authority and holding "[t]o prove a 10(b) violation, the SEC must show (1) material misrepresentations or materially misleading omissions, (2) in connection with the purchase or sale of securities, (3) made with scienter. To show a violation of section 17(a)(1), the SEC must prove (1) material misrepresentations or materially misleading omissions, (2) in the offer or sale of securities, (3) made with scienter. Finally, to show that the defendants violated section 17(a)(2) or 17(a)(3), the SEC need only show (1) material misrepresentations or materially misleading omissions, (2) in the offer or sale of securities, (3) made with negligence.") (citations omitted). Receipt of ill-gotten gains is simply not an element necessary for the SEC's claims to accrue.

[7] FAC ¶ 2 ("the fraudulent scheme *spans seven limited partnership offerings*"); *id*. ¶ 5 ("Quiros . . . made numerous misrepresentations to these foreign investors" prior to making investments); *id*. ¶ 96, *et seq*.

end of the FAC explicitly states it arises from fraud in the offering of the securities.[8] The SEC alleges that (i) Mr. Quiros participated in making misrepresentations in securities offerings, (ii) investors relied on the misrepresentations and, thereafter, (iii) investors made investments.[9] A legal claim accrues – and a statute of limitations period commences – on the date when all elements of the cause of action exist and the SEC can sue, whether for an injunction, penalty, or disgorgement. *Barnes v. Compass Bank*, 568 F. App'x 743, 744 (11th Cir. 2014). And, indeed, Section 2462 mirrors this requirement, prohibiting any action "for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise . . . unless commenced within five years from the date when the claims *first accrued*." (emphasis added.) "[T]he date triggering the clock under § 2462 is the earliest date on which the Government could have brought the present enforcement." *United States v. Dearborn Ref. Co.*, 777 F. Supp. 2d 1077, 1080 (E.D. Mich. 2011). Therefore, as in *Wiand*, any claims accrue under Section 2462 *no later than the date of the allegedly fraudulently induced transactions (i.e., offerings)*. Section 2462 thus bars claims for the Phase I-IV offerings, which each issued prior to April 12, 2011.[10]

C. <u>The SEC Invents A New Legal Standard, Which Finds No Support In Its Cases</u>

As noted, there is ample case law that the SEC's claims accrue no later than the date of the offerings. The SEC offers five unavailing reasons for the Court to hold otherwise.

First, the SEC asserts that the *remedy* sought for a particular claim impacts when it accrues. But the SEC has no cases saying that Section 2462 applies to when a *remedy*, and not a *claim*, first accrued. Indeed, this assertion is directly contrary to the plain language of Section 2462: "within five years from

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("*Misrepresentations and Omission*s in Phases II-VI); *id*. ¶ 116, *et seq*. ("*Misrepresentations and Omission*s in Phases VII") (emphases added).

[8] *Id*. ¶¶ 150, 167, 194, 221 (alleging, under each of the Section 17(a)(1) claims, that Mr. Quiros "employed devices, schemes, or artifices to defraud . . . *in the offer or sale of securities*"); *id*. ¶¶ 170, 197, 224 (alleging, under each of the Section 17(a)(2) claims, that Mr. Quiros obtained money "*in the offer or sale of securities . . . by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in light of the circumstances, not misleading*"); *id*. ¶¶ 153, 173, 200, 227 (alleging, under each of the Section 17(a)(3) claims, that Mr. Quiros engaged in fraudulent conduct "*in the offer or sale of securities*"); *id*. ¶¶ 159, 176, 179, 182, 190, 203, 206, 209, 217, 230, 233, 236, 244 (alleging, under the Section 10(b) and 10b-5(c) claims (and therefore under Section 20(a)), that Mr. Quiros committed "*fraud* upon the *purchasers* of securities" and fraud "in connection with the purchase or sale of securities") (emphasis added).

[9] Securities fraud must connect to the *purchase or sale* of securities. To the extent the SEC is trying to bring claims that Mr. Quiros acted in derogation of offering documents, those claims for breach of contract or mismanagement are not properly brought by the SEC or in the guise of securities fraud.

[10] *See* FAC at ¶ 34 and RJN Ex. 1 (Phase I: Dec. 22, 2006); RJN Ex. 6 (Phase II: March 31, 2008); RJN Ex. 11 (Phase III: July 10, 2010); RJN Ex. 16 (Phase IV: Dec. 22, 2010).

the date when the *claim* first accrued." (emphasis added).[11]

Second, the SEC tries to argue that a new claim accrued "each time" alleged ill-gotten gains were moved from one account to another or when they were used to buy something. (Opp. at 8.) This is nonsensical; an investor cannot lose the same money more than once. For this point, the SEC relies on inapposite cases concerning securities filings: *SEC v. E-Smart Techs.*, 31 F. Supp. 3d 69, 88 (D.D.C. 2014), and *SEC v. Huff*, 758 F. Supp. 2d 1288, 1341 (S.D. Fla. 2010). Both involve companies making misrepresentations in their routine SEC filings – in both cases, the *same issuers* included the *same violations* in disclosures before and after expiry of the limitations period.[12] The courts merely allowed the SEC to sue the issuers for the violations within the limitations period. Here, the FAC alleges *securities offerings*, by *different issuers*, involving *different violations*. They involve discrete one-time losses (and ill-gotten gains) at the time of the offerings.[13]

Third, and relatedly, the SEC tries to apply the "Continuing Violation Doctrine" to extend the limitations period (Opp. at 8-9), but none of its cases is analogous. Rather, they involved unified schemes such as pump and dump frauds (*SEC v. Strebinger*, 114 F. Supp. 3d 1321, 1328 (N.D. Ga. 2015)), or housing discrimination (*Havens Realty Corp. v. Coleman*, 455 U.S. 363, 381 (1982)), where incremental wrongful conduct is part of "a single, indivisible act" or practice. One "continuing injury" is the touchstone of a continuing violation. *See Robinson v. United States*, 327 F. App'x 816, 818 (11th Cir. 2007). The wrongdoing alleged here is divisible into multiple separate entities, making different offerings, to different investors, producing differing and separable alleged injuries.

Fourth, despite trying to create a baroque workaround of *Graham*, the SEC does not actually say that the FAC facially complies with Section 2462. Rather, the SEC argues that "determining when Quiros received ill-gotten gains is a fact intensive inquiry that the Court may not determine on a motion to dismiss." (Opp. at 8.) Not so. On the one hand, the SEC claims (falsely) that the moment of receipt

[11] *SEC v. Monterosso*, 756 F.3d 1326, 1334 (11th Cir. 2014), cited by the SEC, does not concern statutes of limitation, rules of accrual, or the pleading of claims that seek disgorgement. It cannot be read to support the proposition advanced by the SEC. (*Compare* Opp. at 7-8.) *Monterosso* simply concerns the *measure* of disgorgement – *i.e.*, the familiar rule that the SEC's *prima facie* case requires only a reasonable approximation of ill-gotten gains.

[12] Notably, *Huff* involved accrual and a claim by the SEC for disgorgement, but it did not adopt the SEC's proposed rule here: The *Huff* court discussed when claims accrued, which was when the alleged wrongdoing occurred, not when ill-gotten gains occurred.

[13] The SEC's argument that statutes of limitation should be extended because the SEC should not be forced to police "minor frauds" (Opp. at 8) is legally unsupported and, in any case, inapt here. In this case, the centerpiece of the SEC's claims is a time-barred contention, not of alleged "minor fraud," but that Mr. Quiros *purchased a ski resort* in 2008. Thus, any alleged wrongdoing occurred in 2008.

of ill-gotten gains is the very moment of accrual – the last *essential element* of its claims. (*See* Opp. at 7-8 ("until a Defendant has unlawfully acquired money or property, the Commission will not have a complete and present cause of action.").) On the other hand, the SEC remarkably insists that it can simply refuse to plead this supposed *essential element*.

The law does, in fact, require the pleading of ill-gotten gains, insofar as the SEC seeks disgorgement; courts have stricken and dismissed attempts to plead disgorgement, when the SEC has not set forth facts establishing unjust enrichment. *SEC v. Berry*, 2008 U.S. Dist. LEXIS 65914 (N.D. Cal. Aug 27, 2008) (striking a prayer for relief that sought disgorgement and holding "[t]he gaps in the SEC's **allegations speak volumes** and require minimal, but meaningful, additional specificity"; . . . "the defendant has not been unjustly enriched and there is nothing for her to disgorge."); *SEC v. Victorville*, 2013 U.S. Dist. LEXIS 164530 (C.D. Cal. Nov. 14, 2013) (granting motion to dismiss with leave to amend, but noting, "[g]iven that the SEC has engaged in a three-year investigation into this matter, . . . its decision to present no allegations to support of [sic] the request for disgorgement is significant and telling"); *see also Tiller v. State Farm Mut. Auto. Ins. Co.*, 549 F. App'x 849, 856 (11th Cir. 2013) (upholding dismissal of unjust enrichment claim where Complaint failed to allege that plaintiff "actually g[a]ve anything to [Defendant]"). Contrary to the SEC's assertions, then, the law requires it to plead with particularity *when* and *how* Mr. Quiros allegedly received ill-gotten gains.

Fifth, as set forth above, the rule of accrual advanced by the SEC is without support in case law, as is its claim that it need not plead with particularity the circumstances under which Mr. Quiros received ill-gotten gains. It should be noted, however, that – even under the SEC's made-up rule – the FAC reveals that there is one moment in time for each investment Phase when investors parted with money based on fraud and defendants allegedly received ill-gotten gains: *the time of the offerings*.

D. The SEC's Long List Of "Disgorgement Allegations" Shows It Has Not Pled With Particularity

The SEC does not directly counter Mr. Quiros's contention that Rule 9(b) controls the pleading of fraud claims or that, "in alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake." Fed. R. Civ. P. 9(b). Rather, it mischaracterizes its fraud claims as "disgorgement claims" and contends that only a "minimal level of pleading [is] required at this stage of the case." (Opp. at 6.) The SEC's legal premise and conclusion are mistaken.

The SEC's claims are for *fraud*, not disgorgement. "Disgorgement is a remedy for an unjust enrichment action, not an independent cause of action." *In re Burton Wiand Receivership Cases Pending*, 2007 U.S. Dist. LEXIS 22539, at *26-27 (M.D. Fla. Jan. 12, 2007). As such, the SEC's claims must all be pled with particularity under Rule 9. *SEC v. Wall St. Communs., Inc.*, 2009 U.S. Dist.

LEXIS 77174, at *5 (M.D. Fla. Aug. 19, 2009) ("The particularity requirement applies to securities fraud claims brought by the SEC, just as it does to such claims brought by private plaintiffs."); *SEC v. Radius Capital Corp.*, 2012 U.S. Dist. LEXIS 26648, at *6 (M.D. Fla. Mar. 1, 2012) ("Allegations of security fraud are subject to the heightened pleading standards of [FRCP] 9(b).").

Having made up a reduced pleading burden, and in service of its made-up theory that its claims only accrue upon receipt of ill-gotten gains, the SEC lists allegations that it claims are "specific factual allegations concerning disgorgement." (*See* Opp. at 4-5.) They are anything but. The allegations are textbook examples of conclusory allegations; many consist of unsupported and internally contradictory monetary amounts; none sets forth when or how such "ill-gotten gains" occurred or the basis upon which the SEC seeks to remedy the losses. *Razi v. Razavi*, 2012 U.S. Dist. LEXIS 187072, at *14-15 (M.D. Fla. Dec. 13, 2012) (citing *Tello v. Dean Witter Reynolds, Inc.*, 494 F.3d 956, 972 (11th Cir. 2007)) (a complaint only "satisfies Rule 9(b) if it sets forth: (1) precisely what statements were made in what documents or oral representations or what omissions were made, and (2) the time and place of each such statement and the person responsible for making (or, in the case of omissions, not making) same, and (3) the content of such statements and the manner in which they misled the plaintiff, and (4) *what the defendants obtained as a consequence of the fraud*.") (citation omitted; emphasis added).

Moreover, most of the SEC's "specific factual allegations" are not even instances of receipt of ill-gotten gains – they include either (i) the alleged *use* of money long *after* it was supposedly ill-gotten; or (ii) the failure to use money as contractually required. (Opp. at 4-5.) The SEC cannot reduce its pleading burden by avoiding its own allegations that the *offerings themselves* were fraudulent and the *offerings themselves* were how ill-gotten gains accrued.

E. The Court Should, At Minimum, Require The SEC To Amend Its Intentionally Obfuscatory Pleading

As explained above, the FAC makes no attempt to connect its factual allegations to any of its 52 Counts – which are formulaic boilerplate, and the "Relief Requested" makes no connection to any of the 52 Counts. In this way, the FAC is a classic "puzzle" or "shotgun" pleading – it is impossible to know which allegedly wrongful conduct of Mr. Quiros applies to each Count against him, and what the SEC seeks as relief for each instance of wrongful conduct. The court in *In re MCI Worldcom, Inc. Secs. Litig.*, 191 F. Supp. 2d 778, 781-82 (2002), confronted a very similar pleading and commented:

> On first reading, the instinctive reaction is exactly what is intended by Plaintiffs. The numbers are so large, the stakes were so high, and the fall of the dollar value of WorldCom stock so precipitous, that the reader reacts by thinking that there must have been some corporate misbehavior. However, after a thorough examination, it becomes apparent that the

Complaint is a classic example of "puzzle pleading" and that it does not attain the heightened pleadings requirements for this type of case.

Contrary to the SEC's claim (Opp. at n.2), the SEC does not avoid the charge of "puzzle pleading" simply by not incorporating one count in another. The effect of the SEC's obfuscatory pleading is the same: it is impossible to know what facts support which claims and which relief. *See, e.g., Anderson v. Dist. Bd. of Trustees of Cent. Fla. Community College*, 77 F.3d 364, 366-67 (11th Cir. 1996) (granting Rule 12(e) motion in a Section 10(b) case when plaintiff engaged in "shotgun pleading" in which it was "virtually impossible to know which allegations of fact [were] intended to support which claim(s) for relief"). This becomes particularly important here, where most of the SEC's purported claims for disgorgement are time-barred and the SEC has sought to conceal this through clever pleading. To the extent the Court does not order dismissal of claims, the Court should order the SEC, under Rule 12(e), to amend the FAC to comply with *Graham* and plead: (i) what conduct and purported "ill-gotten" gains pertain to which Counts, and (ii) whether the SEC seeks disgorgement, an injunction, or other relief for each Count.[14]

F. The SEC's Selective Pleading Is An Abusive Attempt To Circumvent The Law And Exert Undue Pressure On Mr. Quiros

For the reasons set forth above, there is no good-faith basis for the SEC to pursue its claims regarding offerings that occurred more than five years ago. There is an unseemly reason behind the strategy. The SEC has sought and received the imposition of an asset freeze that is demonstrably larger in size – indeed, vastly larger – than the aggregate value of its disgorgement claims against Mr. Quiros, *including those that are time-barred*. Stripped of its time-barred claims, the asset freeze is even more disproportionate. The SEC has sought an overbroad receivership in an apparent effort to pressure Mr. Quiros financially and to make it difficult for Mr. Quiros to defend himself.

III. THE SEC FAILS TO ADDRESS THE DEFECTS REGARDING PHASES I-VI

A. The SEC Tries To Overwhelm Mr. Quiros With Bulk Rather Than Substance

The SEC and Mr. Quiros agree that Rule 9(b) requires allegations describing "the who, what, when, where, and how of the allegedly false statements and then generally that those statements were made with requisite intent" (Opp. at 10), but disagree about whether the elements have been pled.[15] The

[14] Regarding the remedy, Mr. Quiros asks only that the SEC state *whether* it seeks an injunction, disgorgement, a combination thereof, or some other relief, for each of its Counts. The SEC provides no authority that it is not required to provide this basic pleading, citing cases regarding dismissal for injunctions based on inadequate factual allegations (Opp. at 6-7), and cases that reject a requirement that the SEC plead the *amount* of disgorgement (Opp. at 5-6). Mr. Quiros never made either argument.

[15] The SEC claims that Mr. Quiros has "misstated virtually every legal standard applicable to securities fraud." (Opp. at 18.) The following discussion comprehensively refutes this claim. Counsel for Mr.

Motion raised discrete, but fatal, failures to meet the following pleading requirements:

- Each of the SEC's **fraud** claims requires that Mr. Quiros: (i) personally make; (ii) personally participate in the making; or (iii) have "ultimate authority" for the making of misrepresentations or omissions.
- Claims can arise from **fraudulent conduct**. **But**:
  - Such conduct must *precede* a purchase or sale of securities; **and**
  - Such conduct must be accompanied by misrepresentations or omissions in which Mr. Quiros *personally participated*.

The SEC leaves these key issues largely untouched in its 30-page discursive, relying instead on an exhaustive (and often inaccurate) repetition of its allegations.

B. The SEC Has Not Alleged That Mr. Quiros Was Responsible For Misrepresentations Regarding Phases I-VI Sufficient To State A Claim Under Section 17(a) And Section 10(b) / Rule 10b-5

The SEC argues that Mr. Quiros is "simply wrong" that it failed to allege that he "personally made" or "was legally responsible" for misrepresentations and omissions. (Opp. 18.) The SEC provides no authority to counter that, for *each misrepresentation and/or omission claim* and *each defendant*, the SEC must allege facts showing participation in the making of a misleading statement in direct connection to the purchase and/or sale of securities. *Razi v. Razavi*, 2012 U.S. Dist. LEXIS 187072, at *15 ("The Eleventh Circuit has held that a complaint does not meet Rule 9(b)'s particularity standard where it is 'devoid of specific allegations with respect to each defendant' and instead, merely 'lump[s] together all of the defendants in their allegations of fraud.'").

The SEC cannot demonstrate that it alleged such participation by Mr. Quiros for Phases I-VI. Rather, it presents a long argument based on the familiar rule that defendants can be held liable when they have "ultimate authority" over alleged misrepresentations. (Opp. at 18-21.) But this deceptive argument only concerns AnC Bio Project (Phase VII), *and does not mention Phases I-VI*. This omission is deliberate and illustrates the failure to plead claims sufficiently regarding Phases I-VI. While Mr. Quiros had a role in the General Partner of the Limited Partner of Phase VII (discussed below), the SEC has not and cannot allege that he had a similar role in the Phase I-VI partnerships, or that he played any role in the creation of their offering documents; there is no conceivable basis to conclude that he had "ultimate authority" over offering documents for entities in which he had no role. Accordingly, the Sections 17(a) 10(b) / Rule 10b-5 claims for Phases I-VI cannot survive the Motion.[16]

Quiros have made our arguments carefully, after researching the issues, and based on decades of securities litigation experience.

[16] Notably, after a three-year investigation, the SEC has no allegation that Mr. Quiros participated in the creation of *any* offering document. The SEC's formulaic recitation that – at some unspecified time – "Quiros reviewed the contents of the Phase I-VI offering documents, was familiar with them, and

C. The SEC's Section 17(a)(2) Claims Regarding Phases II-VI Fare No Better

Undaunted, the SEC mistakenly argues that claims under Section 17(a)(2) are proper if a defendant simply received ill-gotten gains from the fraudulent statements of others. (Opp at 21-22, *citing SEC v. Big Apple Consulting USA, Inc.*, 783 F.3d 786, 796 (11th Cir. 2015) and *SEC v. Tambone*, 550 F.3d 106, 129 (1st Cir. 2008).) Those cases are easily distinguishable: both *Big Apple* and *Tambone* involved defendants who *personally sold* securities investments using false information created by others. *Big Apple*, 783 F.3d at 796 (Big Apple used materials created by a third party to misrepresent to investors, prior to their making investments, that the issuer had made a large sale of products.); *Tambone*, 550 F.3d at 129 (Tambone and his partner sold investments as underwriters for a fund using a prospectus created by fund adviser that contained misrepresentations.).[17] Here, Mr. Quiros did not sell any investments. Rather, the *other defendants* made misrepresentations regarding Phases II-VI and *other defendants* sold the investments. This is insufficient for liability under 17(a)(2) because there are no allegations that Mr. Quiros personally engaged in the "offer or sale of securities," let alone "used" the false statements of others in doing so. *Tambone*, 550 F.3d at 127. Moreover, even if the rule were that a claim could arise solely based on Mr. Quiros's receipt of money, the SEC would have to, at minimum, allege *when*. As set forth above, it has not and apparently cannot do this.

D. The SEC's Sections 17(a)(1) And (3) And Rules 10b-5(a) And (c) Claims Regarding Phases I-VI Fail To Show Actionable Conduct By Mr. Quiros

1. The Weight Of Authority Clearly Disfavors Liability For Conduct In The Absence Of Misrepresentations And Omissions

As set forth above, the SEC's allegations that Mr. Quiros made or participated in making misrepresentations or omissions are close to nonexistent for Phases I-VI. Perhaps mindful of this, and despite repeatedly calling its claims "misrepresentations" and "omissions" in the FAC, the SEC tries in

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understood he had to abide by them" (FAC ¶ 51) is insufficient to survive the Motion under *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135 (2011). *See also City of Pontiac Gen. Employees Ret. Sys. v. Lockheed Martin Corp.*, 875 F. Supp. 2d 359, 374 (S.D.N.Y. 2012) ("Plaintiff's conclusory pleading that each defendant had 'ultimate authority' over the statements is clearly insufficient to adequately plead [a defendant] made these statements.").

[17] This case is no longer citable: "*Tambone I* is no longer good law. In *Tambone II* the First Circuit, in an *en banc* decision, expressly rejected the 'implied representation' theory endorsed in *Tambone I*. *Tambone II*, 597 F.3d 436, 442-43 (1st Cir. 2010). Specifically, the *Tambone II* Court held that a securities professional does not 'make a statement' merely by disseminating information created by others. *Id*. In so holding, the Court found no authority in any Circuit that would permit a securities fraud claim based merely on disseminating information created by a third party. *Id*. at 447 (comparing the relatively lenient standard used by the Ninth Circuit for establishing securities fraud with the more stringent "bright-line" test used by the Second, Tenth, and Eleventh Circuits)." *Brown v. J.P. Turner & Co.*, 2011 U.S. Dist. LEXIS 53118, *11-12 (N.D. Ga. May 17, 2011).

its Opposition to recast its claims under Sections 17(a)(1) and (3) and Rules 10b-5(a) and (c) as "scheme" or "course of conduct" allegations. This legal avenue is foreclosed for several reasons.

The SEC argues that, although some courts have held that 10b-5(a) and (c) require pleading that a defendant undertook **both** fraudulent conduct and misrepresentations or omissions, "many other courts have suggested the *opposite*." (Opp. at 25 (emphasis added).) The SEC's authority does not support this conclusion.[18] Nearly every recent court to directly consider the issue has required allegations of *both* conduct and misrepresentations or omissions for liability under Rules 10b-5(a) and (c). The SEC cites two Second Circuit cases, neither of which support its argument,[19] but somehow ignores the Second Circuit's dispositive ruling in favor of Mr. Quiros's argument. *See Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 177-78 (2d Cir. 2005) (requiring both conduct and misrepresentations, and noting "[w]e hold that where the sole basis for [10-b5(a) and (c)] claims is alleged misrepresentations or omissions, plaintiffs have not made out a market manipulation claim under Rule 10b-5(a) and (c)").[20]

Moreover, in addition to the Second Circuit, the Eighth and Ninth Circuits hold that conduct other than misrepresentations must be alleged for a Section 10b5(a) or (c) claim to survive. *See WPP Lux. Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039, 1057-58 (9th Cir. 2011) ("A defendant may only be liable as part of a fraudulent scheme based upon misrepresentation and omissions under Rules 10b-5(a) or (c) when the scheme also encompasses conduct beyond those misrepresentations or omissions."); *Public Pension Fund Group v. KV Pharm Co.*, 679 F.3d 972, 987 (8th Cir. 2012) ("We

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[18] The SEC cites to *Chadbourne & Park LLP v. Troice*, 134 S. Ct. 1058, 1063 (2014), as supporting its argument and quotes from the Supreme Court's passing quotation to the Federal Register. The case discusses unrelated issues concerning the Securities Litigation Uniform Standards Act and certainly does not hold that a plaintiff can bring an action under Rules 10b-5(a) or (c) without *both* misrepresentations or omissions *and* fraudulent conduct. In fact, the Supreme Court noted that courts have not broadly interpreted Rule 10b-5(a) and (c) and noted, as Mr. Quiros does above, that liability does not extend to "'secondary actors' who had no 'role in preparing or disseminating' a stock issuer's fraudulent 'financial statements.'" *Id.*

[19] *SEC v. Pentagon Capital Mgmt, PLC*, 725 F.3d 279, 286-87 (2d Cir. 2013), concerned a defendant with **both** "ultimate authority" over the false statement (a factor not present here at least for Phases I-VI, for the reasons set forth above) **and** who engaged in mutual fund late trading (*i.e.*, wrongful conduct). *VanCook v. SEC*, 653 F.3d 130, 138 (2d Cir. 2011), is very similar to *Pentagon*: the defendant made misrepresentations **and** engaged in deceptive late trading.

[20] The only other case the SEC cites is a case from the Southern District of New York. *SEC v. Simpson Capital Management, Inc.*, 586 F. Supp. 2d 196, 208 (S.D.N.Y. 2008). This case appears to be an outlier. That district, like the Second Circuit, has held in Mr. Quiros's favor on this issue. *See In re Pfizer Inc. Sec. Litig.*, 584 F. Supp. 2d 621, 640 (S.D.N.Y. 2008) (citing *Lentell*, 396 F.3d at 177) (dismissing plaintiff's Rule 10b-5(a) and (c) claims because "plaintiffs allege[d] no deceptive course of conduct going beyond misrepresentations or omissions").

join the Second and Ninth Circuits in recognizing a scheme liability must be based on conduct beyond misrepresentations or omissions actionable under Rule 10b-5(b).").

While the 11th Circuit has not resolved this issue, no district court within the 11th Circuit has concluded that a 10b-5(a) or (c) claim can arise from misrepresentations alone, and two district courts within the Circuit have dismissed plaintiff's such claims for failure to allege fraudulent conduct other than representations and omissions. *See In re Galectin Therapeutics, Inc. Sec. Litig.*, 2015 U.S. Dist. LEXIS 173767, at *21-22 (N.D. Ga. Dec. 30, 2015) (citing *WPP Lux Gamma Three Sarl.*, 655 F.3d at 1057) (noting that "courts have generally held that a Rule 10b-5(a) and/or (c) claim cannot be premised on alleged misrepresentations or omissions that form the basis of a Rule 10b-5(b) claim," and dismissing plaintiff's 10b-5(a) and (c) claims for failing to allege conduct other than misrepresentations); *see also Finnerty v. Stiefel Labs., Inc.*, 2011 U.S. Dist. LEXIS 134234 at *10, n.3 (S.D. Fla. Nov. 21, 2011) (citing *Lentell*, 396 F.3d at 177; *WPP Luxembourg Gamma Three Sarl.*, 655 F.3d at 1057) (finding that plaintiff's securities fraud claim was a Rule 10b-5(b) misrepresentation and omission claim because the complaint "[did] not allege a factual basis for scheme to defraud . . . under Rule 10b-5(a)," and further noting that a misrepresentation and omission claim does not arise under Rule 10b-5(a)).

The weight of authority thus supports that claims under Rules 10b-5(a) and (c) (or Sections 17(a)(1) and (3)) require pleading and proof of both conduct and misrepresentations or omissions. The SEC's misrepresentation allegations fail for the reasons set forth above, which alone is enough to dismiss the claims. The SEC's conduct allegations fare no better for the reasons set forth below.

2. Conduct After An Offering Is Not Actionable Under The Securities Laws, Because, *Ipso Facto*, It Cannot Have Been In Connection With The Purchase And/Or Sale Of Securities

The Opposition provides a list of its "course of conduct" or "fraudulent scheme" allegations, but, revealing a central flaw in the SEC's logic, every single act listed occurred *after* the allegedly fraudulent offerings. (Opp. at 23-24.) Such allegations include commingling of misappropriated money, alleged spending of misappropriated money, and alleged improper uses of margin loans. Even if these actions were in violation of the offering documents (which they were not), they simply could not be securities fraud under any case, including those cited by the SEC. Fraud, whether under the securities laws or common law, necessarily occurs *prior* to induced purchases or sales.

The scheme / conduct liability provisions of Section 17(a)(1) and (3) and Rules 10b-5(a) and (c) require the SEC must plead and prove that wrongdoing is "*in the offer or sale of securities*." *SEC v. Monterosso*, 756 F.3d at 1334 (emphasis added). For instance, *Monterosso* involved a publicly traded company – a company with securities "sold" regularly on an exchange. In that case, defendants forged

invoices in order to inflate sales figures on the company's general ledger and thereby misrepresent the actual revenue of the company in public disclosures. The scheme worked as planned. The defendants committed acts of forgery and participated in the creation of misrepresentations, and *after those acts occurred*, investors purchased stock at inflated values. The SEC thus proved that the defendants' fraud scheme "created a substantial risk of loss [to shareholders] as the revenue overstatements would have been important to any reasonable shareholder." *Id*. at 1338. Here, by contrast, Quiros's alleged conduct – using, taking, and misappropriating investor funds – indisputably occurred *after* the "offer or sale of securities," *after* investors had made their investments.

In re Parmalat Sec. Litig., 376 F. Supp. 2d 472, 504 (S.D.N.Y. 2005), is the same as *Monterosso*. There, the plaintiff alleged that Citibank securitized and sold securities that it should have known were backed by fraudulent invoices that overstated Parmalat's cash flows. *Id*. at 481-82. Again, the false conduct and misrepresentations were connected directly to the sale of securities "that would operate as a fraud or deceit upon others." *Id*. Again, all of Citibank's alleged conduct occurred *before* the sale of securities. The claims against Mr. Quiros solely concern conduct afterward.

Likewise, *In re Global Crossing, Ltd. Sec. Litig*., 322 F. Supp. 2d 319, 324 (S.D.N.Y. 2004), involved defendants fraudulently inflating Global Crossing's stock price, and *then* selling $1.5 billion in stock. Once again, conduct *preceded* the transactions; the SEC has pointed to no case in which conduct *after* a securities sale was held to be actionable under the securities laws. (*Compare* Opp. at 24-27.)[21] This is another fatal infirmity in the pleading of claims regarding Phases I-VI.

E. **The SEC Has Not Alleged Scienter Regarding Phases I-VI**

Scienter (*i.e.*, a state of mind embracing an intent to deceive, manipulate, or defraud) must be pled as to Mr. Quiros *personally*; it cannot be inferred from the actions or statements of others. It consists of either the "intent to defraud" or "severe recklessness." *Edward J. Goodman Life Income Trust v. Jabil Circuit, Inc*., 594 F.3d 783, 790 (11th Cir. 2010); *SEC v. Betta*, 2010 U.S. Dist. LEXIS 25830, at *8-9 (S.D. Fla. Mar. 15, 2010). Here, the SEC has not alleged that Mr. Quiros even read any of the offering documents **prior to the offerings**, let alone reviewed them, contributed to them, or did so with scienter. Moreover, the SEC has not alleged that actions after the offerings were anything more than breaches of contract.

F. **The SEC's Control Person Allegations Fail Regarding Phases I-VI**

Section 20(a) liability requires the SEC to show that (i) the defendant had the power to control

[21] The SEC cites *SEC v. Zandford*, 535 U.S. 813 (2002), for the proposition that it can sue for conduct after a sale of securities. The "conduct" in *Zandford*, unlike this case, involved a series of *additional* fraudulent securities transactions. *Id.* at 818. *Zandford* does nothing to advance the SEC's argument.

the general affairs of the primary violator, and (ii) the defendant had the power to control the specific corporate policy that resulted in the primary violation. *Brown v. Enstar Group, Inc.*, 84 F.3d 393, 396 (11th Cir. 1996). Instead of making this showing, the SEC recites the titles Mr. Quiros holds in separate entities. The SEC cites to no case in which management of one entity is used to infer control under Section 20(a) of a totally separate entity. Here, the SEC has not and cannot make the essential allegation – namely, that Mr. Quiros was the general partner of *any* of the investment limited partnerships, nor that he even had any position in any of the general partners (with the exception of the AnC Bio Partnership). Moreover, as set forth above, the SEC has not alleged any conduct by Mr. Quiros **prior to** the "primary violations," *i.e.*, the sale of the limited partnership securities to investors.

G. The SEC's Aiding And Abetting Allegations Also Fail Regarding Phases I-VI

The Aiding and Abetting claims fail for the same reason as the conduct allegations. The SEC has not alleged Mr. Quiros's participation in or awareness of the contents of any of the offering documents for Phases I-VI **prior to the offerings**. It cites to no case allowing conduct *after* an offering or sale to be actionable under the securities laws.

IV. THE SEC FAILS TO ADDRESS THE DEFECTS IN ITS PLEADING REGARDING PHASE VII / AnC BIO PARTNERSHIP

The SEC's arguments that it has stated a claim regarding Phase VII (Opp. at 18-21) fail to address *Fried v. Stiefel Labs., Inc.*, 814 F.3d 1288, 1294 (11th Cir. 2016), the most recent authority, rejecting an insider's blanket duty to speak. It provides "[a]n individual with a duty to disclose may violate Rule 10b-5(b) by omitting a material fact from a statement … and an individual with a duty to disclose may commit a fraud under Rule 10b-5 by failing to disclose material information … *[b]ut this Court has never held that a failure to disclose material information is an omission under subsection (b) absent a statement made misleading by that failure*." *Id.* (citations omitted; emphasis added).

The SEC's argument assumes that Mr. Quiros had "ultimate authority" over alleged misrepresentations in the Phase VII offering documents, under *Janus*, because (i) he was "one of the managing members of the Phase VII general partner" and (ii) "he reviewed and approved the contents of both offering materials."[22] (Opp. at 19.) On this first point, the SEC provides no authority and no factual allegations that, solely by virtue of a position with a general partner, Mr. Quiros had actual responsibility for statements in the Phase VII offering documents of the limited partnership entity, or even that he had any authority to make such statements. Indeed, *Fried* suggests an insider's position alone does *not* give rise to such blanket obligations, absent an affirmative statement by the insider. On

[22] The SEC adds "[m]ore than one person or entity may have authority over a statement and therefore may be considered the maker of a false statement." (Opp. at 19.) This is irrelevant.

the second point, the SEC only cites its conclusory allegations that Mr. Quiros was one of the "principals" of the Partnership's general partner and, at some unspecified time, he "reviewed and approved the Phase VII offering materials." (Opp. at 19, *citing* FAC at ¶ 27, 52, and 123.) Once again, the SEC has not alleged affirmative misrepresentations or acts by Mr. Quiros **prior** to the purchase or sale of the Phase VII securities. For this reason alone, the claims regarding Phase VII fail.

The SEC's response regarding the substantive Phase VII allegations does not provide any authority allowing it to pursue claims based on now-superseded offering documents. (Opp. at 20, indicating FDA approval claims *only* pertain to "original offering materials.") Each investor had the opportunity to rescind his or her investment, if made pursuant to the original offering documents, rendering the prior offering documents a nullity.[23]

V. THE SEC HAS NOT ADDRESSED THE DEFICIENCY OF ITS PLEADING OF PERMANENT INJUNCTIVE RELIEF, WHICH MUST BE STRICKEN

Mr. Quiros moved that the Court, acting pursuant to Rule 12(f), strike the "'Permanent Injunctive Relief' sought by the SEC under 'Section B' of the 'Relief Requested,'" which is nothing more than an "obey-the-law" injunction. (Motion at n. 3.) *Graham* noted the strong 11th Circuit rule that "obey-the-law" injunctions seeking to bar "future securities violations" are unenforceable:

> Repeatedly we have said that, in the context of SEC enforcement actions and otherwise, "obey-the-law" injunctions are unenforceable. . . . In particular, "an injunction which merely tracks the language of the securities statutes and regulations," as the injunction in this case presently is described, "will not clearly and specifically describe permissible and impermissible conduct" as required by Federal Rule of Civil Procedure 65(d). . . . We "condemn these injunctions because they lack specificity and deprive defendants of the procedural protections that would ordinarily accompany a future charge of a violation of the securities laws."

SEC v. Graham, 823 F.3d at 1362 n. 2 (citations omitted). Section **B** of the Relief Requested in the FAC – which Mr. Quiros moved to strike – meets the *exact definition* of an obey-the-law injunction. The SEC's response is stunningly disingenuous: it says that the request to strike is "meritless" (Opp. at 7) and goes on to say that the "Commission is seeking a conduct-based injunction against Quiros that would prevent him from participating in EB-5 offering and managing EB-5 projects." (Opp. at n. 5.) But that "Conduct-Based Injunctive Relief" is "Section **C**" of the Relief Requested, not "Section **B**."

[23] Moreover, the SEC provides a lengthy discursive on the "bespeaks caution doctrine," which – as the Motion already acknowledged – does not apply when a person *knowingly* misrepresents his belief or states things are possible that have already happened. The problem is a failure to connect Mr. Quiros to the offering documents, let alone show that he *knowingly* misstated cautionary statements. Even if the cautionary language were not effective, the SEC has not pled facts to hold Mr. Quiros responsible.

Dated: September 2, 2016

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this on September 2, 2016, I electronically filed the foregoing document with the Clerk of the Court using CM/ECF. I also certify that the foregoing documents are being served this day on all counsel of record via transmission of Notices of Electronic Filing generated by CM/ECF or in the manner stated in the service list attached.

s/ Scott B. Cosgrove
Scott B. Cosgrove

SERVICE LIST
US District Court, Southern District of Florida
Case No.: 16-cv-21301-DPG

Securities and Exchange Commission v. Ariel Quiros, et al.

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