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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

COMMODITY FUTURES TRADING COMMISSION,	:	Hon. Robert B. Kugler
Plaintiff,		
vs.		**Civil Action No. 04-1512**
EQUITY FINANCIAL GROUP LLC, TECH TRADERS, INC., TECH TRADER, LTD., MAGNUM CAPITAL INVESTMENTS, LTD., VINCENT J. FIRTH, ROBERT W. SHIMER, COYT E. MURRAY, & J. VERNON ABERNETHY		**MOTION DATE: August 19, 2005**
Defendants.		

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TABLE OF CONTENTS

TABLE OF CONTENTS ii
TABLE OF AUTHORITIES iv
I. PRELIMINARY STATEMENT 1

II. ARGUMENT 4

A. Cutting Through The "*Heritage*" Smoke Screen Offered By Plaintiff..... 4
1. It is clear and obvious from the district court decision in *Heritage* that the entity defendant Heritage opened a commodity trading account *in its own name*..... 4
2. Plaintiff's attempt to draw a parallel between the facts of *Heritage* and the facts of Shasta is transparent and ineffective 7
3. Two final *Heritage* points..... 8

B. Shasta Does Not Meet The Definition Of A Pool Found In Plaintiff's Regulation 4.10(d)(1) 9
1. Plaintiff apparently prefers to downplay or ignore a critical phrase found in its own definition 10
2. Plaintiff's "equity" element argument is a reflection of *ad hoc* Administrative desperation 10
3. Plaintiff's discussion of "investee pools" and the statutory definition of a CPO is likewise not persuasive 11
4. Correcting Plaintiff's deliberate factual misstatement 11

C. The Conduct of The Equity Defendants Was NOT "In Connection With" Commodity Futures Trading" And, Therefore, DID NOT Violate Sections 4b(a)(2)(i)-(iii) Of The Act..... 12
1. Any activity alleged to be fraudulent under Section 4b(a)(2)(i)-(iii) of the CEA *must* satisfy the "in connection with" language of that Section to be actionable by Plaintiff. 12
2. Just as Plaintiff's success in pursuing its allegation of fraud against the defendants in *Mass Media* was dependant upon first characterizing those defendants as "Introducing Brokers", similarly Plaintiff's only chance of success in surviving Defendant's current motion for summary judgment is Plaintiff's characterization of the entity Shasta as a "commodity pool".....14
a. Plaintiff's attempt to "distinguish" the *Mass Media* case on its facts does little to further its "in connection with" argument 14
b. Plaintiff's attempt to "distinguish" *Mass Media* based upon the fact that the court was analyzing a regulation of Plaintiff [17 C.F.R. § 33.10 (2004)] instead of statutory language of the CEA likewise does little to further its "in connection with" position with respect to Section 4b of the CEA 15

c. Plaintiff is entitled to little or no "deference" with respect to its interpretation of what constitutes "in connection with" under Section 4b of the CEA 17
3. None of the cases cited by Plaintiff on page 12 of its Response furthers Plaintiff's "in connection with" argument. 18
a. *CFTC v. Vartuli* 18
b. *Saxe v. E.F. Hutton & Co.* 19
c. *Hirk v. Agri-Research Council, Inc.* 20
4. It is currently *not* a violation of the CEA to seek funding for a company (such as Shasta) that never engaged in the trading of commodity interests..... 20

C. The Allegations Contained In Count V Cannot Survive Defendant's Motion For Summary Judgment Unless Shasta Is Held To Be A Commodity Pool..... 21

E. Summary Judgment For The Defendant Is Appropriate And Should Be Granted..... 21

III. CONCLUSION 22

TABLE OF AUTHORITIES

Cases
Celotex Corp. v. Catrett 477 U.S. 317, 322 (1986) 21
Commodity Futures Trading Commission v. Mass Marketing Media 156 F. Supp 2d 1323 (S.D. Fla 2001) 14, 15, 16
CFTC v. Heritage Capital Advisory Services, Ltd., et al Comm. Fut. L. Rep. (CCH) ¶ 21,627 (N.D. Ill. 1982) 4, 5, 6, 7
CFTC v. Vartuli, 228 F.3d 94, 101 (2d Cir. 2000) 18, 19
Hirk v. Agri-Research Council, Inc., 561 F.2d 96, 103-104 (7th Cir. 1977) 20
In re Slusser 1998 WL 537342 (C.F.T.C.) 4
Lopez v. Dean Witter Reynolds, Inc., 805 F.2d 880 (9th Cir. 1986) 2, 9
Nicholas v Saul Stone & Co. 224 F.3d 179 (3rd. Cir 2000) 2
New York Currency Research v. CFTC 180 F.3d 83 at p 88 (2nd Cir. 1999) 8
R&W Technical Services, Ltd. v. CFTC 205 F.3d 165 (5th Cir. 2000) 18, 19
Saxe v E.F. Hutton & Co., 789 F.2d 105, 110-11 (2d Cir. 1986) 19

Statutes
7 U.S.C. § 6b 13, 14
7 U.S.C. § 6b(a)(2)(i-iii)..... ..... 12, 17
7 U.S.C. § 6c(b) 15

Regulations
17 C.F.R. § 4.10(d)(1) 9, 17
17 C.F.R. § 4.30 8
17 C.F.R. § 33.10 .....15, 17

DEFENDANT ROBERT W. SHIMER'S REPLY TO PLAINTIFF CFTC'S RESPONSE TO THE EQUITY DEFENDANTS' MOTIONS FOR SUMMARY JUDGMENT

Defendant Robert W. Shimer (hereinafter "Defendant" or "Shimer") replies to the Response of Plaintiff Commodity Futures Trading Commission (hereinafter "Plaintiff" or "CFTC") to Defendant's previous motion for summary judgment.

I. PRELIMINARY STATEMENT

We all like to win at this game called life. Our courts and system of justice in this country are fashioned to naturally reflect that inherent desire to win. The question of ethics only arises when one encounters the urge or desire to win "at any cost". Clearly our society has devised certain laws and generally accepted rules of conduct to determine if and when that ethical line is crossed. When the power and inherent authority of *government* is brought to bear on private citizens that ethical line is clearly crossed whenever those who represent the government proceed without the authority of either statute or case law and compound that injustice by knowingly presenting factual information again and again to the Court that is neither true nor accurate.

The continued and relentless pursuit of Defendant Shimer and Vincent J. Firth (hereafter "Firth") as well as Defendant Shimer's client Equity Financial Group, LLC (hereinafter "Equity") (all of the above collectively referred to herein as the "Equity Defendants") represents an alarming and extraordinary administrative (and individual) abuse of the enforcement authority granted to Plaintiff by Congress. Following an astoundingly inept initial "investigation" that overlooked completely without any rational justification the individual clearly responsible for perpetrating the massive apparent fraud which is the keystone of the current matter now before the Court; and, following the continued willing cooperation from the outset of all of the Equity Defendants; and, with a factual record that clearly and overwhelmingly points to and supports the fact that the Equity Defendants neither knew or had any reason to know or suspect that the performance numbers being generated by Defendant Coyt E. Murray and continually verified by the CPA Defendant Vernon to Shasta's CPA were inaccurate Plaintiff has, nevertheless, engaged in a continuing and deliberate strategy of 1) again and again offering factual allegations in both its Original and

First Amended Complaint as well as other filings with respect to the Equity Defendants that Plaintiff clearly knew or should have known were not true[1]; and 2) offering to the Court a panoply of various arguments for the astoundingly bizarre proposition that Plaintiff's own cited case of *Lopez v. Dean Witter Reynolds, Inc.* 805 F.2d 880 (9th Cir. 1986) does not really mean what it says.

Defendant finds it particularly curious that Plaintiff would seek to now suggest to the Court (albeit in a footnote) that the Ninth Circuit case of *Lopez* cited by Plaintiff with such initial authority over a year ago on April 1, 2004 "is not controlling in the Third Circuit".[2] While that may be *technically* true, just what is the point of *that* comment? Is Plaintiff suggesting (after having previously cited to *Lopez*) that the Court now ignore *Lopez* and come up with a new "test" for determining whether or not the entity Shasta is a commodity pool? On pages 54 and 55 of his initial Brief dated April 13, 2005 Defendant previously pointed out that the four-part test of *Lopez* was considered by the Third Circuit Court of Appeals to be a sufficiently instructive and accurate authority to be specifically cited with approval in *Nicholas v Saul Stone & Co.* 224 F.3d 179 (3rd. Cir 2000) on page 190 of that court's opinion.[3]

The simple fact of the matter is that there is absolutely no controlling or even relevant case law with facts similar to those that describe the activities of the entity Shasta or any of the Equity Defendants to support Plaintiff's unfounded legal argument that Shasta is a "commodity pool". In attempting to argue otherwise, Plaintiff places "all of its eggs in the one basket" of *Heritage*. The deficiencies of Plaintiff's Heritage "smoke screen" are specifically addressed later in this Brief.

Plaintiff basically asks the Court to literally ignore the clear and specific four-part "test" laid down by its own previously cited case of *Lopez*. The issue now clearly before the Court presented by the Equity Defendants' pending motions to dismiss and the current motion for summary judgment is whether an entity that has never opened a commodity trading account *in its own name* from which commodity interests were ever traded *by anyone* can be characterized as a "commodity pool" as that term is narrowly defined at 17 C.F.R. §

[1] See Page 27, footnote 38 of Shimer's Brief dated April 13, 2005 and also see also pages 64-67 of Shimer's Brief dated April 13, 2005 (incorporated herein by this reference) which recount in detail Plaintiff's more significant deliberate factual distortions.
[2] See footnote 3 found on page 5 of Plaintiff's Response dated August 5, 2005.
[3] See the footnote found on page 190 of the *Nicholas* opinion.

4.10)d)(1). This issue is apparently one of first impression since Plaintiff (being in a unique position to know of the existence of any case law in support of its position) has been unable to cite *a single case* to the Court in support of Plaintiff's position that an entity such as Shasta should be held to be a "commodity pool".

To rule in favor of Plaintiff with respect to Defendant Shimer's current motion for summary judgment would grant to Plaintiff a significant expansion of its administrative authority over an entity never before held by *any* federal court to be a "commodity pool". Plaintiff effectively asks the Court to ignore the carefully crafted four-part definition previously developed by the *Lopez* Court for determining whether or not a particular entity is or is not a "commodity pool". In light of all of the briefs filed with the Court to date the following simple fact is now true and obvious: no court since *Lopez* has expanded or in any way modified the four-part test laid down by *Lopez*. Defendant has not discovered in his legal research *a single instance* in which a federal court has *ever* cited *Lopez* with disapproval. Defendant Shimer, therefore, urges the Court to refrain from doing so now.

Application of the term "commodity pool" beyond the clear and concise four-part test of *Lopez* to entities that have never maintained a commodity trading account "in the name of the purported pool" will expand the definition of "commodity pool" far beyond anything previously recognized by *any* federal court and will confer upon Plaintiff regulatory authority over entities that were never before subject to Plaintiff's registration requirements.

The expansion of Plaintiff's administrative authority over an entity such as Shasta by a radical revision of the currently accepted judicial test for determining what constitutes a "commodity pool" is a decision more appropriately left to Congress. Or, in the alternative, to the more measured and appropriate process of administrative rule making that includes public "feedback" and "comment" similar to that received by Plaintiff when the definition of "commodity pool" was revised more "narrowly" in August of 1980. Any such revised definition if so implemented by Plaintiff without further action by Congress would, of course, then be subject to appropriate judicial review if ever challenged in light of both the language and the legislative history of the Commodity Exchange Act as amended.

II. ARGUMENT

A. Cutting Through The "*Heritage*" Smoke Screen Offered By Plaintiff.

Plaintiff relies on *CFTC v. Heritage Capital Advisory Services, Ltd.* [1980-1982 Transfer Binder] Comm. Futr. L. Rep. (CCH) ¶ 21,627 (ND Ill. 1982) for the proposition that a fund "such as Shasta" has been previously found to be a "commodity pool". Plaintiff contends that the *Heritage* decision is a case "right on point".[4] Plaintiff's review of the district court decision in *Heritage* is as disingenuous as the *Slusser* analysis previously offered by Plaintiff in its response dated June 2, 2005 to Defendant Shimer's Brief offered in support of Shimer's still currently pending motions to dismiss.[5]

Plaintiff begins its *Heritage* analysis on page 4 of Plaintiff's Response. Defendant has no argument or objection to anything stated by Plaintiff on that page 4. On page 5 of its Response Plaintiff finally gets to the "heart of the matter" and discusses the issue of whether or not any information can be gleaned from the district court's decision in *Heritage* with respect to the critical issue of whether or not the defendant entity Heritage maintained a trading account *in its name* (per the stated fourth part of the "test" enunciated in *Lopez*). Plaintiff makes the following patently deceitful and disingenuous statement: "The case is silent on the ownership of the commodity trading account".

1. It is clear and obvious from the district court decision in *Heritage* that the entity defendant Heritage opened a commodity trading account in its own name.

Ignoring only for the moment the issue of whether the *Heritage* "case" is truly "silent" on the ownership of the commodity trading account" as alleged by Plaintiff, the language of the district court in its decision is clearly NOT AT ALL "silent" with respect to the resolution of this significant and critically dispositive issue. As pointed out previously by Defendant Shimer beginning on page 12 of his Reply dated June 8, 2005 the district court in *Heritage* specifically took judicial notice on page 26,379 of the fact that the CFTC's Amended

[4] See Plaintiff's Response, page 3.

[5] See Plaintiff's previous attempt (found on page 13 of its Response dated June 2, 2005 to Defendant Shimer's pending motions to dismiss) to justify a finding that Shasta is a "commodity pool" by citing to and then attaching as an Exhibit all 41 pages of an administrative judge's decision merely for the purpose of quoting an obscure footnote from *In re Slusser*, 1999 WL 507574, 88 (CFTC) and then also see pages 8-11 of Defendant Shimer's reply dated June 8, 2005.

Complaint alleged that "FPB offered three types of investment accounts".[6] Moreover the district court further states on that same page 26,379 as follows: "The first type is a *regular* futures trading account..." (Emphasis added).

Anyone who is *at all familiar* with futures trading accounts knows that a "regular" futures account is an account opened *in the name of the investor* (which in the *Heritage* case was the defendant commodity pool entity Heritage Capital Advisory Services Ltd.). Plaintiff well knows that a "regular" futures account is an account opened *in the name of the investor* that is either traded directly *by the investor*, or, in the alternative, is traded by some other person or entity under power of attorney [in the Heritage case the entity doing the trading was either defendant Serhant or his company Financial Partners Brokerage, Ltd. ("FPB")].

This is a typical Commodity Trading Advisor (CTA) arrangement in which the CTA (in that case the entity FPB) trades the account of the investor (the corporate defendant Heritage) *under the authority of a power of attorney*. For that reason (consistent with the later four-part test of *Lopez)* the entity Heritage was held by the district court to be a "commodity pool" because the entity Heritage clearly was required to open a commodity trading account *in its name* in order to allow FPB to trade on its behalf and that commodity trading account contained the pooled funds of numerous individual separate Heritage investors.

The district court on that same page 26,379 further clearly describes two variations with respect to the type of account offered by FPB to its clients-- the only difference in these two "variations" being *the amount* of investor funds purportedly committed to actual commodity futures transactions. As the district court points out FPB offered a second "variation whereby

> "an investor deposits funds, most of which is used by FPB to purchase a United States Treasury Bill at the current discount rate. The additional amount *of customer funds* representing the difference between the face value of the United States Treasury Bill and its actual purchase price is then traded in the futures market." [7] (Emphasis added)

The district court then described the third type of account offered to its customers by FPB (distinguished again only by the percentage of customer funds used to purchase the United States Treasury Bill):

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[6] See generally the Heritage decision attached as Exhibit D to Defendant's previous filed Reply dated June 8, 2005.
[7] *CFTC v. Heritage Capital Advisory Services, Ltd.* [1980-1982 Transfer Binder] Comm. Futr L. Rep. (CCH) ¶ 21,627 at p. 26379 (ND Ill. 1982)

> "In the third type of account approximately two thirds of the customer funds are used to purchase a United States Treasury Bill and the remaining one third is used to speculate in the futures market."[8]

An additional and dispositive statement of the *Heritage* court with respect to the issue of whether or not the Defendant Heritage maintained a commodity trading account *in its name* at FPB is found immediately after the above cited quotation on that same page 26,380 of the district court's decision:

> "That Complaint further alleged that *as to all types of accounts offered*, FPB and Serhant had complete discretion in and control over the assets and funds of its customers." (Emphasis again added).

In addition to all of the above, the *Heritage* district court spends time discussing the two investment accounts opened at FPB which received investor funds. As noted by the court the first investment account of the defendants was named the "Jeffery Weaver Omnibus account" ("JWO") evidently opened with FPB on or about May, 1981. Later, as the district court also notes in its finding of fact:

> "In October and November 1981 Jeffrey and Ward Weaver formed Heritage to manage the customer investments. During this period the defendants transferred the customer accounts from the Jeffery Weaver Omnibus account to an account entitled the 'Heritage Capital Advisory Services, Ltd.' account". [9]

The district court's findings of fact note that CFTC examiners wanted "to verify that customer funds were in fact being deposited into the JWO and the HCAS accounts…":

> "to verify that customer funds were in fact being deposited into the JWO and the HCAS accounts, Mr. Zimmerle and Mr. Kozlowski traced a sample number of customer deposits into the bank accounts *for those two accounts*. (Emphasis added).[10]

Note that the above description of the district court clearly distinguishes between the JWO and HCAS *investment* accounts (which were clearly commodity trading accounts opened at

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[8] *CFTC v. Heritage Capital Advisory Services, Ltd.* [1980-1982 Transfer Binder] Comm. Futr L. Rep. (CCH) ¶ 21,627 at pp. 26379- 26380 (ND Ill. 1982).
[9] *CFTC v. Heritage Capital Advisory Services, Ltd.* [1980-1982 Transfer Binder] Comm. Futr L. Rep. (CCH) ¶ 21,627 at p. 26380 (ND Ill. 1982).
[10] *CFTC v. Heritage Capital Advisory Services, Ltd.* [1980-1982 Transfer Binder] Comm. Futr L. Rep. (CCH) ¶ 21,627 at p. 26381 (ND Ill. 1982).

FPB) and separate bank accounts that were evidently also opened in the name of both of these accounts). As the district court then states:

> "That tracing analysis showed that in most cases customer funds could be traced directly into one of the two accounts."[11]

2. Plaintiff's attempt to draw a parallel between the facts of *Heritage* and the facts of Shasta is transparent and ineffective.

Part of the *Heritage* "smoke screen" presented by Plaintiff's Response is contained in Plaintiff's discussion of the fact that Heritage funds were evidently withdrawn from either of the above referenced investment accounts at FPB and first sent to an FPB bank account before being disbursed back to a Heritage bank account.[12] The fact that funds were withdrawn from either the JWO or HCAS investment accounts at FPB and first sent to a bank account of FPB before being transferred back to a bank account of Heritage is completely irrelevant to the issue of whether or not Heritage maintained a commodity trading account in its own name at FPB. In this transparently ineffective attempt to "draw a parallel" between the facts of Shasta and the facts of Heritage, Plaintiff states on page 5 of its Response"

> "...and the facts indicate that Heritage withdrew funds from its pooled accounts and sent them to FPB, which deposited them in its account at Berwyn National Bank, just as Tech Traders deposited Shasta funds into its account at Bank of America" [13]

With all due respect to Plaintiff: "so what"? All that tells us is that both FPB and Tech Traders had bank accounts into which investor funds were deposited either prior to or after investment activity. What does that fact have to do with the issue of whether or not the Defendant entity Heritage owned *in its name* a commodity trading account at FPB?

As a final point, Plaintiff concludes at the bottom of page 5 of its Response that the fact that *Lopez* relied upon *Heritage*, "shows that the name on the commodity trading account is not a factor in determining whether a commodity pool exists". In light of all that has been previously pointed out with respect to the actual facts of Heritage AND, in light of the incontrovertible fact that the *Lopez* court formulated its four-part test (including the critically

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[11] *CFTC v. Heritage Capital Advisory Services, Ltd.* [1980-1982 Transfer Binder] Comm. Futr L. Rep. (CCH) ¶ 21,627 at p. 26381 (ND Ill. 1982).
[12] See page 5 of Plaintiff's Response.
[13] See also page 5 of Plaintiff's Response.

significant fourth sub-part) clearly citing *Heritage* when creating that four-part test Defendant is tempted to once again borrow from Judge Cardamone of the Second Circuit that "certain aspects of *this* case have an Alice in Wonderland quality about them".[14] (Emphasis added).

3. Two final *Heritage* points.

In conclusion, Defendant Shimer would urge the Court to consider the following two points:

1) If, as correctly stated above by the *Heritage* district court, FPB had complete discretion "over the assets and funds of its customers" "as to all types of accounts offered" then, (as Plaintiff has alleged with respect to defendant Tech in Count V in the present matter)[15], it would have been a clear violation of Plaintiff's own regulation found at 17 C. F. R. § 4.30 for FPB to have traded the funds of its customers *from an account in FPB's name*! That violation was never alleged by Plaintiff in *Heritage* and is never discussed by the district court in its recited findings of fact. This is merely a further indication that FPB did *not* engage in such a violation of Plaintiff's regulations by trading pooled customer funds from a commodity trading account established *in the name of FPB!!!*

2) Plaintiff is clearly in a unique position to know there is absolutely no doubt that defendant Heritage opened an account *in its own name* at FPB because that part of the "Complaint" (quoted by the district court in *Heritage* as noted by Defendant above) was, in fact, *drafted by Plaintiff. Moreover it was clearly Plaintiff's own investigators that were given the job of tracing funds from the bank accounts of Heritage to the investment accounts at FPB.* For Plaintiff to purport to represent to the Court in the present matter that " The case is silent on the ownership of the commodity trading account" is as perilously close to an outright deceptive statement as one can possibly achieve without engaging in a direct lie.

And yet to press this argument, Plaintiff "pretends" in its Response that it is not clearly aware of all of the "facts" in the *Heritage* case! Defendant Shimer suggests that the Court require Plaintiff to produce the entire district court trial transcript of *Heritage.* When that transcript reveals that Defendant Shimer's representation to the Court is correct with respect

[14] See *New York Currency Research v. CFTC* 180 F.3d 83 at p 88 (2nd Cir. 1999)
[15] See Count V, paragraphs 101 through 106 found at pages 34 and 35 of Plaintiff's First Amended Complaint.

to this critical issue Defendant Shimer respectfully suggests that the Court not only grant Defendant's motion for summary judgment with respect to all counts of Plaintiff's First Amended Complaint **but, in addition, impose such sanctions upon both Plaintiff and Plaintiff's lead counsel as the Court may find appropriate for the willingness of both Plaintiff and Plaintiff's lead counsel to engage in this clear, obvious and deliberate misrepresentation to the Court.** The Court *clearly* has the authority to request that Plaintiff produce the *Heritage* trial transcript at Plaintiff's own expense and Defendant Shimer respectfully suggests that such a request by the Court would serve as an appropriate means to clearly dispel the "smoke screen" offered by Plaintiff with respect to *Heritage*.

B. Shasta Does Not Meet The Definition Of A Pool Found In Plaintiff's Regulation 4.10(d)(1).

On page 6, Section II B of its Response Plaintiff first cites the definition of a "pool" found in its own Regulation 4.10(d)(1), 17 C.F.R § 4.10(d)(1) and then offers to the Court a discussion that purports to "prove" that Shasta is a commodity pool under the cited definition. Before addressing Plaintiff's specific comments, Defendant would point out that the four-part test enunciated by the Ninth Circuit Court of Appeals in 1986 (decided six years *after* Plaintiff revised its definition of the term "pool") was obviously necessary because as the *Lopez* court pointed out:

> "While numerous courts have dealt with the concept of commodity pools in the abstract, few have specifically attempted to define what constitutes a pool. The Commodity Exchange Act fails to provide any assistance in this regard."[16]

It is important to remember that the definition of the term "pool" found at 17 C.F.R. § 4.10 (d)(1) *was clearly available to the Lopez Court at the time it formulated its four part test in 1986!* It is instructive to note that Plaintiff's definition of the term "pool" found at 17 C.F.R. § 4.10(d)(1) was never *even mentioned* by the *Lopez* court as a helpful *starting point* in determining what does and what does not constitute a "commodity pool" because Lopez was obviously more concerned with fashioning a *practical* test that would move beyond the "abstract" one line definition found at 17 C.F.R. § 4.10(d)(1)

[16] *Lopez v. Dean Witter Reynolds, Inc.* 805 F.2d 880, 884 (9th Cir. 1986).

If the Plaintiff's regulatory definition is so helpful in determining the issue currently before the Court *now* (when *at least one* if not three of the four parts of the Lopez test are arguably inapplicable to Shasta), why wasn't it dispositive in 1986 with respect to the Dean Witter CGAP account? Clearly the issue of "pro rata apportionment" (never mentioned in Plaintiff's definition of the term "pool"), was sufficiently dispositive for the *Lopez* court to *exclude* the Dean Witter CGAP pooled commodity trading account from the definition of the term "commodity pool" even though all other parts of that court's newly formulated four-part test were clearly met!

1. Plaintiff apparently prefers to downplay or ignore a critical phrase found in its own definition.

Not wanting to allow silence to be taken as any sort of implied acceptance, it is necessary to at least quickly address several points made by Plaintiff in Section II B of its Response. Plaintiff's discussion found on page 6 (and continued on page 7) of its Response highlights the words "the purpose of trading" but neglects to highlight or emphasize the previous words "operated for". As previously pointed out in Defendant's Reply dated June 8, 2005 the use of the verb "operated" before the phrase "for the purpose of trading commodity interests" clearly acts to restrict the definition to entities that actually *engage* in trading—hence the use of the specific words "in the name of the pool" found in the fourth test of *Lopez*. *In every instance* of Plaintiff's discussion found on pages 6 and 7 about the background discussion or comments about what entities should or should not be included within the definition of "pool" there is always *some degree* of actual trading of commodity interests contemplated *by the purported pool entity*. Whether an entity is trading occasionally or minimally such a distinction does not further Plaintiff's attempt to include within its definition of "pool" an entity that has *never traded* commodity interests.

2. Plaintiff's "equity" element argument is a reflection of *ad hoc* administrative desperation.

On the top of page 8 of its Response Plaintiff's makes an "equity" argument that since the returns being reported by Defendant Tech and Defendant Murray were "fictitious" somehow that fact alone should require a finding that Shasta is a commodity pool. But what if the

returns being generated by Defendant Tech's trading system were *accurate* as innocently reported by Shasta to its members? Would that fact then *exclude* Shasta from the administrative reach of Plaintiff? It is hard to imagine Plaintiff taking the opposite side of that argument! This sort of topsy turvy suggestion is more the by-product of Plaintiff's apparent *ad hoc* sense of administrative necessity than thoughtful and careful consideration about what and what does not constitute a "commodity pool".

3. Plaintiff's discussion of "investee pools" and the statutory definition of a CPO is likewise not persuasive

Plaintiff's discussion of "investee pools" on page 8 hardly furthers its argument with respect to Shasta. This discussion simply describes the relationship that entities already determined to be pools might have with each other. It does nothing to address the issue of whether Shasta qualifies as a "pool" in the first place. The fact that Plaintiff received "no comments" from the industry with respect to the layering of entities already considered to be "pools" does not further its argument with respect to the entity Shasta. If all entities in the layering process are already assumed to be pools, where is the need for industry comment?

On page 9 of its Response Plaintiff plays a game with the statutory definition of the term Commodity Pool Operator. This definition has been adequately briefed *ad nauseum* by both Plaintiff and Defendant and requires no further comment from Defendant other than to point out, once again, that the *Lopez* court obviously must have looked at that definition at the time it formulated its four part test and found (as stated in its opinion) that existing statutory definitions were of little help when a court is asked to determine whether the facts of a particular situation justify characterizing a particular entity as a commodity pool.

4. Correcting Plaintiff's deliberate factual misstatement.

Plaintiff's comment at the bottom of page 9 cannot be left unanswered. Plaintiff inaccurately states: "The fact that Shasta investors invested in commodities through this intermediary, as noted by Shimer…" Defendant has previously taken great pains to point out that neither Shasta nor its members ever "invested in commodities". This misreported gratuitous "fact" offered by Plaintiff is not a "fact" at all. It merely represents wishful thinking on the part of Plaintiff. The contractual arrangement that existed between Shasta and

Defendant Tech did NOT result in an investment in commodity interests by either Shasta or its members. It simply conferred upon Shasta and its members the contractual right to receive from Tech an allocation of either profits or losses that Tech might sustain as the result of the trading of commodity futures by defendant Tech *for the benefit of the commodity trading account established solely in the name of Defendant Tech.*[17]

C. The Conduct of The Equity Defendants Was NOT "In Connection With" Commodity Futures Trading" And, Therefore, DID NOT Violate Sections 4b(a)(2)(i)-(iii) Of The Act.

1. Any activity alleged to be fraudulent under Section 4b(a)(2)(i)-(iii) of the CEA *must* satisfy the "in connection with" language of that Section to be actionable by Plaintiff.

Plaintiff states in Part B III on page 10 of its Response that Defendant is "dead wrong" that Shasta must be found to be a commodity pool in order for Count I to survive Defendant's motion for summary judgment. But why Defendant Shimer is "dead wrong" is never at all explained. Plaintiff states that the "reason" is set out in the "CFTC Response at 9".[18] Plaintiff's Response dated August 5, 2005 does not make that argument on page 9. The only other "Response" submitted to the Court by Plaintiff in response to motions by Defendant is dated June 2, 2005. Page 9 of that particular Response contains a paragraph that refers to Count V—not Count I. Plaintiff's only "reasoning" (if you can call it that) with respect to Count I is found on page 8 of its June 2, 2005 Response.

Plaintiff offers to the Court on that page 8 no argument at all for why a failure on the part of Plaintiff to establish that Shasta is a commodity pool should still allow Plaintiff to proceed against the Equity Defendants with respect to Count I. Plaintiff recites on page 8 of its previous Response the various merits related "elements" the courts have held must be present before a finding of fraud can be sustained under Section 4b(a)(2)(i)-(iii) of the Commodity Exchange Act, 7 U.S.C. § 6b(a)(2)(i)-(iii). Those elements being 1) a misrepresentation, 2) that is material and 3) made with scienter. Plaintiff apparently purports to argue that since "commodity pools" are not literally mentioned in this section of the CEA Shasta's status as a

[17] See also discussion of this point found on page 87 of Defendant's Brief dated April 13, 2005.
[18] See CFTC Response dated August 5, 2005, page 10.

commodity pool is not relevant to Plaintiff's pursuit of the Equity Defendants under Section 4b(a)(2)(i).

However, as Plaintiff well knows, Section 4b of the CEA *requires* that the specific activities alleged must satisfy Section 4b's "in connection with" language before it becomes appropriate for a court to engage in a merits based analysis to determine if the activity that meets the statute's "in connection with" language was, indeed, a material misrepresentation made with scienter. The clear and unambiguous language of Section 4b itself obviously presented a particularly unique legal hurdle or difficulty for Plaintiff when drafting the language of Count I of its First Amended Complaint with respect to the Equity Defendants. In the interest of clarity, the full text of Section 4b, 7 U.S.C. § 6b is attached hereto as Exhibit "A".

A review of the specific language of the Statute reveals the full extent of Plaintiff's difficulty *as a matter of law*. Plaintiff clearly is NOT authorized by the Statute with absolute discretion to charge *anyone* it may choose with fraud. The language of the Statute is very clear. For the sake of clarity, and to further demonstrate Plaintiff's obvious legal difficulty, the following statement injects into the actual language of the Statute the parties at issue in the present matter (the Equity Defendants who are alleged to have committed fraud under the Statute and the members of the entity Shasta who are alleged by Plaintiff to be the victims of this "fraud"):

> "It shall be unlawful for any person (meaning the Equity Defendants) in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery made or to be made, for or on behalf of any other person (a member of the entity Shasta) if such contract for future delivery is or may be used for
> (A) hedging any transaction in interstate commerce in such commodity…;or
> (B) determining the price basis of any transaction in interstate commerce in such commodity…;or
> (C) delivering any such commodity…
> (i) to cheat or defraud …such other person (a member of the entity Shasta);
> (ii) willfully to make or cause to be made to such other person (a member of the entity Shasta) any false report or statement thereof, or willfully to enter or cause to be entered for such other person (meaning any member of Shasta) any false report thereof;
> (iii) willfully to deceive or attempt to deceive such other person (a member of the entity Shasta) by any means whatsoever in regard to any such order or contract…"

The "in connection with" language of the Statute specifically restricts the applicability of Section 4b of the CEA to instances where the person being accused of fraud *has engaged in behavior associated with either an order to make or the making of a contract of sale of any commodity for future delivery for the person who was allegedly defrauded!* Because none of the Equity Defendants ever *actually* engaged in any trading of commodity futures contracts on behalf of either themselves or on behalf of anyone else (including the members of the entity Shasta) it is absolutely critical to the success of Count I that the entity Shasta be characterized as that type of entity that has been specifically defined by both the Plaintiff and recognized by the courts as being an entity that engages in commodity futures trading for the benefit of its members. For that reason and for that reason alone, the language of Count I engages in a legal fiction that refers again and again to the alleged fraudulent acts of the Equity Defendants as being fraudulent acts conducted against members of the "Shasta "pool".

2. Just as Plaintiff's success in pursuing its allegation of fraud against the defendants in *Mass Media* was dependant upon first characterizing those defendants as "Introducing Brokers", similarly Plaintiff's only chance of success in surviving Defendant's current motion for summary judgment is Plaintiff's characterization of the entity Shasta as a "commodity pool".

a. Plaintiff's attempt to "distinguish" the Mass Media case on its facts does little to further its "in connection with" argument.

Plaintiff attempts in its Response dated August 5, 2005 to "distinguish" the case of *CFTC v. Mass Media Marketing, Inc.*, 156 F. Supp. 2d 1323 (S.D. Fla. 2001) from the present case by first comparing and distinguishing the actual activities engaged in by the *Mass Media* defendants with the alleged activities of the Equity Defendants. Plaintiff points to the fact that the *Mass Media* defendants created commercials and infomercials directed towards those members of the general public that might be interested in investing in options on commodity futures. Plaintiff then attempts to "contrast" that activity of the *Mass Media* defendants by stating that the Equity Defendants "aggressively solicited investors through their web site..."[19] Plaintiff also seeks to make much of the fact that the Equity Defendants "did not

[19] Just why creating commercials and infomercials that broadly solicit the general public with respect to the merits of an investment in options on commodity futures contracts does not deserve the adverb "aggressive" but a private web site that was never offered to any search engine and that could not be viewed by *anyone* unless the person first

just pass the names of Shasta investors along to Tech Traders..." These statements by Plaintiff do little to further any analysis of the critical "in connection with" language of Section 4b of the CEA currently at issue. Perhaps the obvious "distinction" noted by Plaintiff between the activities of the *Mass Media* defendants and the Equity Defendants lies in the simple fact that the *Mass Media* defendants were in the business of ***making television and radio commercials for clients*** while the Equity Defendants were assisting in a Regulation D private placement for the benefit of the entity Shasta and it members.

b. Plaintiff's attempt to "distinguish" *Mass Media* based upon the fact that the court was analyzing a regulation of Plaintiff [17 C.F.R. § 33.10 (2004)] instead of statutory language of the CEA likewise does little to further its "in connection with" position with respect to Section 4b of the CEA

Plaintiff seeks to further "distinguish" the *Mass Media* decision by pointing out that the court there held Plaintiff's authority to promulgate regulations pursuant to the provisions of Section 4c(b) of the CEA, 7 U.S.C. § 6c(b) did not allow Plaintiff to apply those particular regulations found at 17 C.F.R. § 33.10 to the activities of the *Mass Media* defendants. Just why that fact is helpful to the Plaintiff's "in connection with" argument with respect to Section 4b of the CEA is an unanswered mystery.

What is significant for purposes of analysis of the "in connection with" language of Section 4b of the CEA (which Plaintiff seeks to apply to the Equity Defendants in the present matter) is the fact that the language of Plaintiff's regulation found at 17 C.F.R. § 33.10 (applicable to commodity *option* transactions) was discussed by the court in *Mass Media*. The language of that regulation (as drafted by Plaintiff) closely tracks the statutory language of Section 4b of the CEA!!! In *Mass Media* Plaintiff argued that the phrase "in connection with" (as stated in its regulation) should be broadly interpreted to mean "by any means whatsoever":

> "According to the CFTC, Defendants "fall squarely" within its anti-fraud regulations because through their advertisements they engaged in fraud, "directly or indirectly" "in connection with" commodity options "by any means whatsoever".[20]

specifically represented to Shasta that they qualified as an "accredited Investor" and then chose a specific password in order to view Shasta's web site qualifies as "aggressive" solicitation is conveniently not explained by Plaintiff.

[20] *CFTC v. Mass Media Marketing, Inc.*, 156 F. Supp. 2d 1323, 1333 (S.D. Fla. 2001)

Defendant Firth "that do not participate in commodity trading transactions". **6)** The Equity Defendants "participated" in commodity trading transactions *only if the entity Shasta is characterized as a "commodity pool"*. **7)** It is, therefore, absolutely critical to Plaintiff's ability to survive Defendant's current motion for summary judgment that the entity Shasta be characterized as a "commodity pool" (thus subjecting the Equity Defendants to the registration requirements of the CEA) in order to sustain at least the "legal fiction" that the "in connection with" language of Section 4b of the CEA is satisfied.

c. Plaintiff is entitled to little or no "deference" with respect to its interpretation of what constitutes "in connection with" under Section 4b of the CEA

For all of the seven reasons stated immediately above in section II C. 2 b of this Brief, it should now be clear to Plaintiff why Defendant took the time to review the analysis of the Supreme Court in *Betts*. The *Mass Media* court engaged in a *Chevron* analysis and rejected Plaintiff's previous claim that the "in connection with" language found in its regulation at 17 C.F.R. § 33.10 should be interpreted to mean "by any means whatsoever". Though Plaintiff has not chosen to specifically repeat that particular argument *in exactly those same words* in the context of the present issue with respect to Section 4b of the CEA, all of Plaintiff's arguments really amount to that same position: that the "in connection with" language of Section 4b of the CEA should also basically mean whatever Plaintiff feels it should mean at any particular time. This attitude, of course, also permeates all of Plaintiff's arguments offered for the proposition that the entity Shasta meets the definition of "pool" found at 17 C.F.R § 4.10(d)(1) and should be characterized as a "commodity pool. Neither interpretation deserves any deference from the Court. Under the clear and unambiguous language of Section 4b(a)(2) of the CEA the "cheating" or "defrauding" has to occur in connection with the making of a contract *for or on behalf of* another person and the cheating or defrauding has to be directed to the person on whose behalf the contract of sale for future delivery was made.

3. None of the cases cited by Plaintiff on page 12 of its Response furthers Plaintiff's "in connection with" argument.

The cases of *CFTC v. Vartuli*, 228 F.3d 94, 101 (2d Cir. 2000), *Saxe v E.F. Hutton & Co.*, 789 F.2d 105, 110-11 (2d Cir. 1986) and *Hirk* v. Agri-Research Council, Inc., 561 F.2d 96, 103-104 (7th Cir. 1977) cited by Plaintiff at the bottom of page 12 of its Response DO NOT support Plaintiff's argument that the activities of the Equity Defendants, as alleged in Count I (in the absence of a finding that the entity Shasta is a commodity pool) are sufficient to provide the necessary "connection" to commodity trading to enable Plaintiff's allegation of Section 4b fraud to survive Defendant's current motion for summary judgment.

a. *CFTC v. Vartuli*

The *Vartuli* defendants were advertising or selling a very specific trading program to the public to allow individuals who purchased the trading program to actually *trade commodity futures*. The Defendants' customers paid a licensing fee for a computer software program for trading commodity futures that customers installed on their computer. Those customers then procured a market reporting service to feed current market prices to the computer and then acted on the instructions given by the Defendants' system. The software did not perform as advertised and evidence showed that the defendants in *Vartuli* continued to market that software after receiving complaints from customers about the trading system's performance.

The *Vartuli* Court was justified in finding the necessary "connection" to commodity trading to sustain a Section 4b claim of fraud in that instance *because the people who purchased the trading programs sold by the Vartuli defendants either actually engaged in the trading of commodity futures after purchasing the trading program that was sold to them or, at the very least, purchased the commodity trading program being sold with the intention of trading commodity interests.*

The federal courts have routinely been willing to find (and appropriately so) that the activity of selling to the public a software trading program that is represented to be able to successfully trade commodity futures is activity sufficient to qualify anyone who engages in that sort of selling or advertising as a Commodity Trading Advisor (CTA). See, for example, *R&W Technical Services, Ltd. v. CFTC* 205 F.3d 165 (5th Cir. 2000) where the court there

also engaged in an extensive discussion and analysis of the "in connection with" language of Section 4b of the CEA. R&W Technical Services, Ltd. sold computer software to individuals interested in trading commodity futures contracts. The court in *R&W Technical* found a sufficient "connection" to trading to justify Section 4b liability. In so doing the court noted that it agreed with the CFTC's conclusion that "respondents misled potential purchasers of their system concerning trading profits and trading risks *in order to induce customers to trade, and there is ample evidence to show that they did trade.*"[24] (Emphasis added).

b. *Saxe v E.F. Hutton & Co*

Saxe v E.F. Hutton & Co., 789 F.2d 105, (2d Cir. 1986) is also easily distinguished from the present matter. After Plaintiff Barry Saxe suffered "dramatic losses" in his stock account at E.F. Hutton, Scott A. Howard, a Vice President at E. F. Hutton suggested that Plaintiff Saxe open a commodity trading account with Hanger Associates, Inc. a registered commodities trading advisor. When Saxe expressed apprehension about commodities trading, Howard attempted to allay his fears and, according to the court, claimed to Saxe (among other things) that Hanger "always made money for its clients".[25]

In reversing the district court's dismissal of the Saxe's CEA related Section 4b claim, the Fifth Circuit stated:

> "We emphasize, however, that our decision is premised on the discretionary nature of Saxe's account. Appellant, who knew little, if anything, about the commodities market, placed all decisions concerning the purchase and sale of specific futures within the discretion of the appellees. Thus, misrepresentations about the risks of commodities trading *affected all subsequent trades made on appellant's behalf.*" [26] (Emphasis added).

The individual who was alleged to be the subject of the alleged Section 4b fraud (appellant Saxe) *had opened an actual commodity trading account* at the suggestion of the defendant and trading losses had been sustained from trading that occurred *in the appellant's account.*

[24] *R&W Technical Services, Ltd. v. CFTC* 205 F.3d 165, 173 (5th Cir. 2000
[25] *Saxe v E.F. Hutton & Co.*, 789 F.2d 105, 107 (2d Cir. 1986)
[26] *Saxe v E.F. Hutton & Co.*, 789 F.2d 105, 110 (2d Cir. 1986)

c. *Hirk v. Agri-Research Council, Inc.*

In *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96, 103-104 (7th Cir. 1977) the plaintiff Hirk had been fraudulently induced to enter into a trading agreement with defendant Agri-Research Council, Inc. whereby Hirk opened a discretionary futures trading account with Miller-Lane & Co., an ARCO futures commission merchant, placed $10,000 in that account and gave discretionary trading authority to one of the defendants based upon certain representations of profitability made to him by the defendants. Hirk lost money as a result of trading on his behalf *from the commodity trading account opened in his name*. Even though the "deceptive conduct" evidently occurred *prior* to the actual trading of Hirk's account (a reason the district court had previously failed to recognize Hirk's Section 4b claim under the CEA), the Fifth Circuit found that such behavior on the part of the defendants sufficiently satisfied the "in connection with" language of Section 4b to sustain a claim by Hirk under the CEA. Once again, as in Saxe, the "victim" of the alleged Section 4b fraud *had actually opened a commodity trading account at the suggestion of the defendants*, thus providing the necessary and required "connection" to commodity trading.

4. It is currently *not* a violation of the CEA to seek funding for a company (such as Shasta) that never engaged in the trading of commodity interests.

These particular cases cited by Plaintiff do not further Plaintiff's "connection" argument because *none of the members of Shasta ever engaged in the actual or intended trading of commodity futures as a result of any of the alleged activities of the Equity Defendants.* It is *not* a violation of the CEA to seek funding for a company (such as Shasta) that does not actively engage in the trading of commodity interests and has never represented to anyone that it intended to engage in the trading of commodity interests.

The Equity Defendants never represented to *anyone* that members of Shasta would engage in the trading of commodity interests nor was a membership interest in Shasta ever purchased by anyone with that intention or expectation *nor did any member of Shasta ever open a commodity trading account as the result of the actions of the Equity Defendants.* None of the cases cited by Plaintiff support Plaintiff's position that representations that may have been made in all innocence about the effectiveness of a commodity trading system *owned* by Defendant Tech and *operated solely* by Defendant Tech for the purpose of trading

commodity futures *in the name of Defendant Tech* are sufficient to satisfy the "in connection with" language of Section 4b(a)(2) of the CEA.

Plaintiff's *only* ability to "connect" the alleged activities of the Equity Defendants to any act proscribed by the CEA is, therefore, clearly dependent upon characterizing the entity Shasta as a "commodity pool". As has been previously pointed out by Defendant, one need only read Count I of Plaintiff's First Amended Complaint to see that is true. Plaintiff's primary difficulty is the fact that the Ninth Circuit *Lopez* case Plaintiff previously cited does *not at all* support that "conclusion" nor has Plaintiff been able to provide to the Court *any other federal case law* which would support this unfounded conclusion by Plaintiff.

D. The Allegations Contained In Count V Cannot Survive Defendant's Motion For Summary Judgment Unless Shasta Is Held To Be A Commodity Pool

Defendant finds nothing in Plaintiff's Response that requires further argument with respect to Count V. The Court is respectfully referred to Defendant's Brief dated July 7, 2005.

E. Summary Judgment For The Defendant Is Appropriate And Should Be Granted.

Defendant takes no issue with any of the case law cited on pages 2-3 of Plaintiff's Response. These cases do not refute or in any way impair the propriety of granting summary judgment to Defendant with respect to all five Counts of Plaintiff's First Amended Complaint. The inability of Plaintiff to prove that Shasta ever opened or owned a commodity trading account *in its name* represents a failure on the part of Plaintiff to establish the existence of "an essential element of the non moving party's case" which "necessarily renders all other facts immaterial".[27] Moreover Plaintiff admits as true the fact that such an account was never opened in Shasta's name from which commodity interests were ever traded.[28]

For that reason, there is a sufficient basis under controlling summary judgment case law to grant Defendant's pending motion for summary judgment because this essential material fact is a necessary fourth element of the four-part test laid down by the *Lopez* court. If the

[27] *Celotex Corp. v. Catrett* 477 U.S. 317, 322 (1986)
[28] See footnote 1 on page 1 of Plaintiff's Response dated August 5, 2005

Court agrees with both Defendant and Plaintiff[29] that *Lopez* is a persuasive authority with respect to the issue of what elements are necessary to establish the existence of a "commodity pool", the absence of such an account in the name of the alleged Shasta "pool" satisfies current summary judgment case law and Defendant's motion should be granted with respect to all Five Counts.

III. CONCLUSION

While Plaintiff may be understandably frustrated at the lack of federal case law precedent and statutory authority to support all Five Counts of its First Amended Complaint with respect to the Equity Defendants that frustration is of Plaintiff's own making. A proper initial investigation would have clearly uncovered the parties truly culpable in this matter (defendants Murray and Abernethy) and would have permitted Plaintiff to craft a Complaint supported by existing statute, regulation and case law. Instead of recognizing its error and the clear limitations imposed by applicable case law and its own enabling Statute, Plaintiff chose to continue its "pursuit" of the Equity Defendants in a First Amended Complaint despite the fact that Plaintiff was in a unique position to well know that its enabling Statute, the legislative history of that Statute and existing federal case law did not offer *any support* for such a choice.

In the humble opinion of Defendant, certainly an ethical line and arguably a legal line was deliberately crossed in this case to the severe detriment of the Equity Defendants. The inherent power and authority of government to virtually shatter and disrupt the lives of private citizens is a power and authority that should be exercised with great discretion and with measured and careful restraint and certainly not when such an action is undertaken by employees of a federal agency without the support of either case law, the Plaintiff's enabling Statute or that Statute's legislative history.

If Plaintiff finds it necessary to seek greater administrative authority over entities such as Shasta and its manager Defendant Equity, Plaintiff is free to seek that additional authority from Congress. If Plaintiff prefers, instead, to engage in additional rule making and amend its

[29] See Page 2, footnote 1 of Brief In Support Of Plaintiff's Motion For *Ex Parte* Statutory Restraining Order and Preliminary Injunction dated April 1, 2004.

EXHIBIT A

§ 6b. Fraud, false reporting, or deception prohibited

Release date: 2005-05-25

(a) Contracts designed to defraud or mislead; bucketing orders
It shall be unlawful
(1) for any member of a registered entity, or for any correspondent, agent, or employee of any member, in or in connection with any order to make, or the making of, any contract of sale of any commodity in interstate commerce, made, or to be made, on or subject to the rules of any registered entity, for or on behalf of any other person, or
(2) for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery made, or to be made, for or on behalf of any other person if such contract for future delivery is or may be used for
(A) hedging any transaction in interstate commerce in such commodity or the products or byproducts thereof, or
(B) determining the price basis of any transaction in interstate commerce in such commodity, or
(C) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof—
(i) to cheat or defraud or attempt to cheat or defraud such other person;
(ii) willfully to make or cause to be made to such other person any false report or statement thereof, or willfully to enter or cause to be entered for such person any false record thereof;
(iii) willfully to deceive or attempt to deceive such other person by any means whatsoever in regard to any such order or contract or the disposition or execution of any such order or contract, or in regard to any act of agency performed with respect to such order or contract for such person; or
(iv) to bucket such order, or to fill such order by offset against the order or orders of any other person, or willfully and knowingly and without the prior consent of such person to become the buyer in respect to any selling order of such person, or become the seller in respect to any buying order of such person.

CERTIFICATE OF SERVICE

The undersigned does hereby certify that on August 15, 2005 he caused a true and correct copy of the foregoing Reply of Defendant to Plaintiff's Response to Defendant's Motion for Summary Judgment to be sent via regular U.S. Mail to the following.

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