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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

Defendants.

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BRIEF OF DEFENDANT ROBERT W. SHIMER IN SUPPORT OF MOTIONS FILED PRO SE ON BEHALF OF HIMSELF AND MOTIONS FILED SEPARATELY BY VINCENT J. FIRTH PRO SE PURSUANT TO FEDERAL RULES 56(b), 12(b)1 and 12(b)6 FOR SUMMARY JUDGMENT AND DISMISSAL WITH RESPECT TO ALLEGED VIOLATIONS OF SECTIONS 4b(a)(2); 13b; 4*o*(1); 4k(2); 4m(1); & 13(a) OF THE COMMODITY EXCHANGE ACT, 7 U.S.C. §§ 6b(a)(2); 13c(b); 6*o*(1); 6k(2); 6m(1); & 13c(a).

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In The 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

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BRIEF OF DEFENDANT ROBERT W. SHIMER IN SUPPORT OF MOTIONS FILED PRO SE ON BEHALF OF HIMSELF AND MOTIONS FILED SEPARATELY BY VINCENT J. FIRTH PRO SE PURSUANT TO FEDERAL RULES 56(b), 12(b)1 and 12(b)6 FOR SUMMARY JUDGMENT AND DISMISSAL WITH RESPECT TO ALLEGED VIOLATIONS OF SECTIONS 4b(a)(2); 13b; 4*o*(1); 4k(2); 4m(1); & 13(a) OF THE COMMODITY EXCHANGE ACT, 7 U.S.C. §§ 6b(a)(2); 13c(b); 6*o*(1); 6k(2); 6m(1); & 13c(a).

Defendants Robert W. Shimer ("Shimer") and Vincent J. Firth ("Firth") each acting pro se on behalf of themselves submit this Brief in support of their respective separate Motions To Dismiss and for Summary Judgment.

I. PRELIMINARY STATEMENT

The Division of Enforcement ("hereinafter Division") of the Commodity Futures Trading Commission ("CFTC" and "Plaintiff") conducted far more than a hasty and incomplete investigation which resulted in many unjustified charges being brought against Shimer, Firth and Shimer's legal client Equity Financial Group, LLC ("Equity"). The Division's "investigation" of Shimer's client Shasta Capital Associates, LLC ("Shasta") set a new low water mark for Federal

agency investigative competence. Facts were offered to this Court with virtual reckless indifference to their truth in support of Plaintiff's Original Complaint and *Ex Parte* Request For Statutory Restraining Order and Preliminary Injunction issued with respect to Shimer, Firth and Equity (hereinafter collectively referred to as "Equity Defendants"). The result has been an unnecessarily devastating assault on the personal reputations of both Shimer and Firth that has disrupted their lives and caused them great financial hardship.

Shimer and Firth acknowledge the necessity and importance of taking swift action in the face of evidence of fraud in the market place but respectfully submit to this Court that the Division and specifically attorneys and investigators of the Division vested with the authority conferred upon them by Congress have a personal responsibility and obligation to conduct *at least the semblance* of an adequate investigation to insure that unwarranted, discriminatory and unsupported charges are not brought against private citizens and that core malefactors are not ignored and/or overlooked.

In the present matter Shasta has been the victim of an alleged fraudulent scheme perpetrated by defendants Tech Traders, Inc., ("Tech") Tech Traders, Ltd., (Tech Ltd") and Coyt Murray ("Murray"), with the apparent willing support of defendant J. Vernon Abernethy ("Abernethy") and perhaps others not yet charged, yet Shimer, Firth and Equity have borne the unjustified brunt of the Division's preliminary injunctive action. Legal fees billed to Shimer and Firth by their previous counsel have exceeded *by a factor of four* the reasonable expectation of legal counsel Samuel Abernethy when Menaker & Herrmann was initially retained by the Equity Defendants in April of 2004.

The Division's civil action filed on April 1, 2004 (while admittedly necessary to avoid further dissipation of assets held by Defendants Tech and Murray) was astoundingly replete with misstated, erroneous and totally unsupported facts cited as a basis for precipitous *Ex Parte* emergency injunctive relief that was neither warranted nor necessary with respect to the Equity Defendants.[1] The most astounding aspect of the Division's Original Complaint was its failure *to even mention* defendant Murray and defendant Abernethy--the two individuals *clearly*

[1] Shimer and Firth do not challenge the clear statutory authority conferred upon Plaintiff by Congress to proceed *Ex Parte* against them but only question the necessity of such action with respect to themselves in light of the many facts readily available to the Plaintiff if only Plaintiff had been more responsible during the early stages of its investigation. Moreover Plaintiff cannot contend that it did not have sufficient time to conduct at least the semblance of an adequate investigation of Shimer's client Shasta. Plaintiff's investigation had certainly begun by early January, 2004 and Plaintiff's Complaint for Preliminary Injunction and Plaintiff's Motion for *Ex Parte* Restraining Order were not filed until April 1, 2004.

responsible for the apparent massive fraud perpetrated not only against the members of Shasta but against numerous other victims still unknown to Shimer and Firth.

In the present matter it is not sufficient to state that the Division could have conducted a more thorough and complete investigation. The first obvious inadequacy of the Division's "investigation" was its apparent inexplicable eagerness to studiously avoid the most obvious step of contacting the Washington, D.C. law firm of Arnold & Porter (and more specifically Geoffrey Aronow a partner in that prestigious firm who held the position with the CFTC of Director of Enforcement from 1995 until 1999).

The CFTC cannot deny that the firm of Arnold & Porter was retained by Shimer in late October, 2003—a full 5 months prior to the filing of the Division's Original Complaint. Arnold & Porter was contacted by Shimer and was specifically asked to serve as outside securities counsel for the benefit of Shimer's legal clients Shasta and Shasta's manager defendant Equity.[2] Even more inexplicable is the fact that the Division apparently chose to avoid any relevant contact with the Certified Public Accounting firm of Puttman & Teague, clearly known to the Division and retained by Shasta since 2001.

Had the Division chosen to avail itself of these most obvious and relevant sources of significant information, the Division would have discovered that Shimer's legal client Shasta had entered into an investment agreement in good faith with defendant Tech for the placement of Shasta's funds with Tech, and that Shimer and Firth not only believed, but had good reason to believe that defendant Tech was truly producing the return on investment claimed and consistently reported to Shasta in writing every month by Tech's president defendant Murray.

Moreover, the Division would have also easily and immediately learned the identity of defendant Abernethy and that Shimer and Firth had in good faith, (and after much negotiation and effort by Shimer) put in place as the result of correspondence and communication between Shasta's CPA Elaine Teague ("Teague") (a partner in the Portland Oregon CPA firm of Puttman & Teague) and Abernethy (a CPA local to Tech's trading operation in Gastonia, North Carolina with a very acceptable resume and no stated or known prior affiliation to either Defendant

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[2] Plaintiff CFTC cannot assert with any credibility that it did not have actual or, at the very least, constructive notice that Arnold & Porter represented Shasta as that fact was clearly posted on the Hedgeco web site (http://www.hedgeco.net/) specifically mentioned twice by Plaintiff in its Original Complaint filed April 1, 2004. (See Original Complaint ¶ 23, page 8 and Original Complaint ¶ 26, page 9).

Murray or defendant Tech)[3] a procedure for verification of Tech's trading performance that Shimer and Firth then believed and still believe was reasonable and sufficient (if followed and adhered to by Defendant Abernethy) to insure that the profit/loss figures consistently reported by Tech to Shasta were accurate.

Plaintiff alleged several times in its First Amended Complaint that the Equity Defendants "knew" that Abernethy was not independent.[4] Nothing could be further from the truth. Plaintiff cannot with any credibility dispute that all of the following eight facts are absolutely true and are readily discernible from the record: **a)** Abernethy met Murray for the first time in 2001 in the context of apparently seeking a CPA to perform trading performance verification for Tech; **b)** there was no past history of *any* collusion between Abernethy and Murray apparent to Shimer when he first met Abernethy nor has subsequent investigation by Plaintiff discovered any such past collusion between Abernethy and Murray prior to 2001; **c)** Abernethy did not actively seek to refer prospective investors to Shasta until early 2002; **d)** the simple mathematics (addition, subtraction and division) required by Abernethy to arrive at a return on investment percentage to verify Tech's trading performance was well within Abernethy's ability as a CPA; **e)** Abernethy referred only one person to Shasta who actually became a member of Shasta in June of 2002; **f)** that particular member remained a member for only 1 ½ months and then withdrew from Shasta at the end of July, 2002; **g)** Abernethy never referred *any other* people to Shasta after July 2002; **h)** there is absolutely *no evidence* in the record that Shimer and Firth had *any* knowledge of, or even *suspected* that Abernethy was working closely with Howell Woltz to place funds with Tech through a Sterling managed entity.

In short, there was no basis at all for Shimer and Firth to suspect that Abernethy's ability to perform reliable independent verification of Tech trading performance was compromised in any way. Shimer and Firth believed that an adequate procedure for verifying Tech's trading performance on a monthly basis was in place to protect Shasta's investors, and the record supports a finding that this good faith belief by both Shimer and Firth was reasonable.

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[3] It was apparent when Shimer met Abernethy for the first time in early July of 2001 that Abernethy had no prior affiliation with Murray and nothing during that first conversation led Shimer to believe otherwise. That this initial impression by Shimer was accurate was confirmed directly by Abernethy himself during his deposition taken by the CFTC on June 8, 2001 when he testified under oath that he met Murray for the first time in 2001 when Murray came into his Gastonia office looking for the services of a local CPA (see pp 35 & 36 of Abernethy deposition).

[4] See ¶ 45, page 21& ¶48, p. 21 of First Amended Complaint.

The good faith of Shimer and Firth and their lack of knowledge of the misrepresentations of Defendant Tech and Murray (and what now appears to be either the stunning incompetence or active collusion with Murray by Abernethy), evidence of which abounds throughout the factual landscape of this apparent investment fraud, act to bar (with respect to both Shimer, Firth and Equity) all charges of fraud under Section 4b(a)(2) of the Commodity Exchange Act (Act"), 7 U.S.C. § 6b(a)(2); all charges of controlling person liability under Section 13b of the Act, 7 U.S.C.§13c(b) and all charges of violation of Section 4*o*(1) of the Act, 7 U.S.C. § 6*o*(1).

Furthermore a careful reading of both case law as well as the CFTC's own regulations contradicts the Division's repeated and carefully crafted attempt to characterize Shasta in its Original and later in its First Amended Complaint as a "commodity pool" and, therefore, to cast defendant Equity as the "operator" of that pool. If Shimer's client Shasta is not a "commodity pool" then Shimer's client Equity cannot be the "operator" of a commodity pool and, as a matter of law, Plaintiff CFTC has not met its clear burden to establish subject matter jurisdiction with respect to the alleged violation of Sections 4b(a)(2), 4k(2), 4m(1) and 4*o*(1) of the Commodity Exchange Act 7 U.S.C. §§ 6b(a)(2), 6(k)(2), 6m(1) and 6*o*(1) by Shimer, Firth and Equity. Nor has Plaintiff CFTC met its clear burden to establish subject matter jurisdiction with respect to the alleged violation of Section 13(b) of the Commodity Exchange Act, 7 U.S.C. § 13c(b) Act by Shimer and Firth.[5] Nor has Plaintiff CFTC met its clear burden to establish subject matter jurisdiction with respect to the alleged violation of Section 13(a) of the Commodity Exchange Act, 7 U.S.C. § 13c(a) with respect to Shimer.[6] Nor has Plaintiff CFTC met its clear burden to establish subject matter jurisdiction with respect to the alleged violation of Section 2(a)(1)(B) of the Commodity Exchange Act 7 U.S.C. § 2a(1)(B) with respect to Equity.[7]

II. STATEMENT OF FACTS

A. Background

Shimer met with Murray in late October or early November of 2000. That meeting was occasioned by the fact that defendant Shimer's client Kaivalya Holding Group, Inc. ("Kaivalya")

[5] See Count I, First Amended Complaint, ¶ 59; Count II, First Amended Complaint, ¶ 76; and Count III, First Amended Complaint, ¶ 80.
[6] See Count III, First Amended Complaint, ¶ 81 & Count V, First Amended Complaint, ¶ 104.
[7] See Count II, ¶ 75, First Amended Complaint & Count IV, First Amended Complaint ¶ 87.

had been the victim of a previous fraud by other individuals using Murray's purported trading skills as "bait". Murray expressed a sincere desire during that initial meeting to help correct that situation and to do what he could to help make Shimer's client whole. Shimer believed Murray was sincere in his willingness to help and there was no evidence available at the time of Shimer's first meeting with Murray in Murray's Gastonia office that would have led Shimer to believe otherwise. Shimer's belief was only further confirmed in Shimer's mind when Murray confirmed to Shimer that Murray had separately sent to each of the individuals who had perpetrated the fraud against Kaivalya a "cease and desist" letter. Those separate letters each dated March 24, 2001 and written by Murray stated in part as follows:

> "It has come to my attention that you and your associates have been using my good name for the stated purpose of raising funds for making a private placement investment with me or my company. Attorney Robert Shimer supplied these and other allegations of misconduct and the supporting documentation."

Murray's letter of March 24, 2001 to each of these individuals further stated in part:

> "I am disappointed that our relationship never developed, and am dismayed by the recent allegations against you. In light of the above, I have no alternative at this time but to provide you with this notice of cease and desist."[8]

Shortly after this initial meeting with Murray, Shimer invited Firth (whom he had met previously) to join him for another meeting with Murray who was the president of defendant Tech. During that initial meeting with Shimer and Firth, Murray reiterated that he had, indeed, developed a sophisticated computer driven futures trading program that was capable of generating consistently positive returns. A few follow up meetings occurred in December, 2000. Murray explained to Firth and Shimer in that first meeting and in follow up meetings that his computer driven futures trading program was based upon what appeared to be a brilliant combination of multiple component sub-programs all operating on different time frames using different mathematical parameters to reduce risk and enhance profitability. Murray called his trading program the Synergy Trading System.

Murray provided both Firth and Shimer with back trading data analysis for calendar year 2000 for the Synergy Trading System. The data presented to Shimer and Firth showed consistent

[8] A copy of each of these two letters dated March 24, 2001written by Murray were recently provided willingly to Plaintiff by Shimer per a Request for Production by Plaintiff.

extraordinary projected profits even after factoring in slippage and appropriate broker commissions. Shimer and Firth were also each provided by Murray with identical white three ring binders that provided extensive detailed performance analysis of each sub-component of the Synergy Trading System.

Shimer formed Edgar Holding Group, Inc. ("Edgar") a Delaware corporation with Firth as President and Shimer as Chief Financial Officer. To test Murray's unique trading system in real time and with an eye toward beginning the process of helping to make his client Kaivalya whole, Shimer loaned Edgar $150,000.00 of his own funds. A friend of Shimer's who had personal experience with futures trading programs also loaned $100,000.00 to Edgar and those combined funds were, in effect, loaned to another entity that, in turn, loaned Edgar's funds to Murray's company Tech Traders, Ltd. ("Tech Ltd") a Bahamian based International Business Company (IBC) controlled by Murray. That other intermediate entity later executed separate loan documents with Tech Ltd. but Edgar's funds were placed directly in a U.S. bank account controlled by Murray.

Based upon the trading results for the Synergy Trading System during the early part of 2001 with respect to the Edgar source funding reported to Shimer by both Murray and by his son Coyt A. Murray ("Lex") (the purported programming mathematical "wizard" for the Synergy Trading System) and based upon the continuously expressed desire of both Murray and Lex to fully fund all sub components of the Synergy Trading System, Shimer, in his legal capacity, then helped to form a Nevis limited liability company by the name of New Century Trading, LLC ("New Century") in early April of 2001. New Century executed an investment agreement with defendant Tech Ltd to place funds on behalf of New Century directly with Murray's domestic Delaware corporation defendant Tech. Tech performed all actual trading in the United States from its Garrison Blvd. offices in Gastonia, North Carolina.

This initial offshore "arrangement" using an entity such as the newly formed New Century was developed primarily because Murray continually expressed a preference (prior to the events of 9/11) that all funds placed for Synergy System trading be provided to Murray through agreements executed by and between an offshore entity and Murray's Bahamian based entity Tech Ltd. Shimer and Firth were told by Murray that Tech Ltd actually owned the Synergy Trading System technology but had licensed it to Murray's domestic entity Tech.

Shimer had no conceptual objection to helping to form a foreign entity and knew of people in Nevis willing to run and manage an entity such as New Century. All management control of New Century was eventually vested in New Century's manager, Allied International Management, Ltd. ("Allied") a Bahamian IBC formed for that purpose by reputable legal counsel in Nassau, Bahamas. Allied which was managed and controlled by the people Shimer knew in Nevis. Firth and Shimer were not granted any management position in New Century or in its manager Allied. Shimer performed legal services for both New Century and its manager Allied.

B. <u>Initial Confirmation of Tech and Murray's Trading Prowess</u>

Initial information provided to both Shimer and Firth by Murray and his son Lex about the Synergy Trading System's ability to generate profits was positive and seemed very impressive.[9] Throughout the late winter and early Spring of 2001, prior to the formation of New Century Shimer received regular reports from Murray with respect to the account set up at Tech that contained the funds that had originated from Edgar. These monthly reports showed profitable trading in the account consistent with the previous back testing disclosed to Shimer and Firth for the Synergy Trading System during calendar year 2000. The reports received by Shimer from Murray not only reported extraordinary gains but also seem to reflect a certain market savvy and macroeconomic financial sophistication on the part of Murray.[10] In May, 2001

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[9] One written example of the representations being made by both Murray and his son Lex to Firth and Shimer is found in an e-mail mail from Lex Murray dated Wednesday, January 10, 2001 sent at 1:09 AM. This was about the time that Edgar's funds were being first provided to Murray. Lex's e-mail attached an executable file (.exe file) that purported to contain "a few charts showing all 20 systems on the Nasdaq mini contract (electronically traded on Globex)."
Lex's e-mail continued as follows: "These charts show almost all of our systems, not just the 8 that are in the Synergy portfolio (I told you I narrowed it down). I do these charts for myself from time to time to assess system performance, as there are tests that I run in Excel that are unavailable in the trading software. (There I go pushing the envelope again). Thought you might like to see these, though. 52.7% on 5X margin in 19 days! Not bad. (that's something like 26,291% APR) The majority of the systems have not been tuned through optimization!"
Lex's e-mail to Firth and Shimer further stated: "These are all shown on a 5 minute time frame. I made no attempt to diversify via correlation analysis or apply money management strategies…"
Lex's e-mail then continued: "We usually trade the NQ (mini) as opposed to the ND due to speed of entry and the fact that the contract is 1/5th the size of the big ND. The margin on the NQ is set at <8,000 so I used 5X=$40,000 per system as initial equity, with the slippage/commission @ $100/contract."
Lex's e-mail concluded: "As we grow, it will quickly become necessary to trade the ND for larger lots. This is not a problem, we still enter electronically, it just takes 5 to 15 seconds for a fill report rather than 1 or 2."

[10] <u>The first written report received by Shimer from Murray</u> for the $250,000 placed in January, 2001 by Edgar was very positive. Murray stated; "It is with great pleasure that we report for the period ending Feb 16th 2001, we

$40,000.00 was withdrawn from the account at Tech containing Edgar's funds. Again in June, 2001 another $20,000.00 was withdrawn at Edgar's request. Each time these separate requests for withdrawal of funds representing the principal amount loaned by Edgar were promptly honored by Murray with no objection.

In August, 2001 Edgar requested a combined withdrawal of $80,000.00 in principal from the funds held by Tech. Again Murray showed no objection or reluctance on Murray's part to make this repayment to Edgar. Edgar's remaining principal balance of $110,000.00 was finally repaid in January of 2003 by Tech again with no objection from or reluctance by Murray. Despite these previous withdrawals of principal by Edgar, the account established through Tech Ltd. designated for the original receipt of Edgar's loan of $250,000.00 showed a balance of exactly $927,880.00 according to Murray and Tech based upon a trading performance that had been continuously verified and confirmed in writing for every month since June, 2001 by the

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achieved a gross profit of $90,796, of which $40,858.20 is credited to your account, bringing your balance to $290,858.20. Murray's correspondence continued: "Please bear in mind that while your funds were utilized to the fullest extent possible, all of your funds were not available for trading for the entire time period. Also several good trades were missed due to our policy of not trading (or lightly trading) on days when key government or economic reports may adversely affect volatility. We would rather miss a good trade occasionally than put your (and our) funds at undue risk."

<u>The second report received by Shimer from Murray</u> for Edgar funds placed with Murray was similarly upbeat and reported very positive trading results: "We are pleased to report that for the 6 week period ending Feb 28th 2001, we achieved a gross profit of $150,955, of which $68,616 is credited to your account, bringing your balance to $318,616. This is an additional $27,758 2-week return." Murray's letter further stated: "Again several good trades were missed due to our policy of not trading on days when key government or economic reports."

<u>Murray's third report to Shimer</u> with respect to Edgar source funds stated in part: " We are pleased to report that for the period ending March 31st 2001, we were able to credit to your account $16,568, bringing your balance to $335,184. This is a 5.2% net monthly return, and a 34.1% 10 week net return which equates to an APR of about 360%. That letter from Murray to Shimer continued in part: "We are still treading cautiously, with a reduced system-portfolio. Indications are that this is a bear market rally, but possibly one with considerable upside potential, especially in the Nasdaq. Short term, we expect a retracement to support, since markets never move in a straight line for very long and we are presently very overbought."

Murray then offered in that third written report to Shimer (what appears with several years of "hindsight") to be the following very astute comments made in the Spring of 2001: "Big financial news came forward Wednesday morning in the form of a surprise Federal Reserve short-term interest rate cut of another 50 basis points. The Fed is clearly panicked as this makes four rate cuts in as many months, and drops the overnight rate to 4.5% where it stood in August 1994. The Fed's actions are de facto confirmation that the economy is in much worse shape then they had been admitting in past press releases. The folly is to believe that they can magically fix everything with a reduction in one particular overnight lending rate. More importantly, to my knowledge this was the first time the Fed has publicly admitted to targeting the level of the stock market. …Thus the Fed has now "officially" sown the seeds of its own destruction by finally admitting that they must ensure a rise in equities to stem a reduction in "consumption." …The whole notion of a government agency centrally planning the direction of the economy through the manipulation of a single short-term interest rate is an exercise in theoretical absurdity. …When the market eventually breaks down below its respective late March and early April lows (and it is destined to eventually do just this) then the real panic will start as investors slowly come to realize that the Fed is ineffectual."

local certified public accountant defendant Abernethy.[11]

On behalf of his client New Century Shimer (with the assistance of Firth) negotiated with Murray as follows: for any funds placed for Synergy System trading by New Century's investors Tech Ltd would first provide those investors with a 2% preferential return on investment per month from any available trading profits before Murray's company Tech Ltd. was entitled to *any* profit sharing. If profits remained for further division after that initial preferential profit allocation to New Century and its investors, Tech Ltd. would be allocated 15% of all profits actually realized during the month to cover, in part, the office and overhead expenses of the domestic trading entity Tech.

Thereafter, any remaining trading profits for the month still available would be equally divided between Tech Ltd and New Century for the benefit of its investors. Shimer was adamant that New Century's investors should receive this substantial "preferred return" on their investment from any available profits created from trading each month *before any allocation to Tech Ltd* in light of the fact that the Synergy Trading System lacked any substantial track record. Murray further agreed as an accommodation to Shimer to allocate to another client of Shimer's Shadetree Investment Trust ("Shadetree"), (the sole shareholder of New Century's manager Allied) a portion of any trading profits that might be properly apportioned to Tech Ltd as a result of funds placed by New Century through Tech Ltd. [12]

This allocation to Shadetree (the sole shareholder of New Century's manager Allied) seemed to be a reasonable means to slowly create sufficient funds to allow for eventual repayment of the previous losses suffered by Shimer's client Kaivalya. This allocation between Murray's company Tech Ltd. and Shadetree did not at all affect the substantial and preferential profit sharing allocated to New Century's investors by the investment agreement executed between New Century and Tech Ltd.[13] If the trading system continued to work as initial reports

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[11] All of these basic facts with respect to Background and also Murray's apparent trading prowess cannot be disputed by Plaintiff and can be easily verified by the Court.

[12] Allied was formed by a reputable law firm in Nassau, Bahamas.

[13] The record clearly shows that Murray consistently insisted on receiving an allocation amounting to 50% of any profits generated on funds placed by any individual investor or by any investor entity through Tech Ltd. for trading by Tech or placed directly with Tech. For that reason any further greater sharing of profits with either New Century (or later with Shasta's investors) would not have been acceptable to Murray in the absence of his apparent willingness to help solve Kaivalya's past problem through a voluntary allocation of a part of Tech Ltd.'s profits to Shimer's client Shadetree. Examples of this standard 50/50 profit sharing arrangement by and between Murray and

from Murray indicated, the arrangement seemed to Shimer to be a perfect "win win" situation for everyone-for New Century's investors and for Tech Ltd., as well as for both Shadetree and also for Shimer's client Kaivalya.

C. Trading Performance Verification & Formation of Shasta

With the clear belief based upon Edgar's experience with Murray and Tech that the Synergy Trading System was working just as had been predicted by Murray's back testing data for calendar year 2000, but wanting to be extra certain of the accuracy of the performance numbers that would be reported by Tech Ltd to New Century, Shimer proposed to Murray beginning in early March of 2001 that a procedure to protect New Century's prospective investors be put in place for independent verification of trading performance.[14] Shimer suggested that Elaine Teague ("Teague"), a friend of his and also a partner in the CPA firm of Puttman & Teague in Portland Oregon be permitted to review the original brokerage statements generated as a result of Tech's trading each month. Shimer knew and trusted Teague. He knew that if Teague confirmed that the trading performance numbers being reported by Tech Ltd to New Century were indeed accurate, that he could rely upon that representation by Teague.

Tech investors abound through out the record. (See for example, Exhibit #55 to Vernon Abernethy Deposition taken July 1, 2004 which is a sample of the standard "Trader/Lender" Agreement offered by Murray to his "investor/lenders". The pages of that Exhibit designated as CFTC 202 03 0242 through 0243 refer to the typical 50/50 profit sharing arrangement that Murray required. An similar 50/50 division applied to the funds provided by Shimer's client Edgar.

See also Exhibit # 65 of deposition of Vernon Abernethy taken on July 1, 2004 [specific Profit Sharing Agreement setting forth the "understanding of certain "partners" with respect to a fund known as the "Strategic Investment Portfolio". Those named "partners" included Murray, Abernethy and Howell Woltz and others, who all apparently agreed that 50% of profits generated by the trading of the Portfolio's funds were to be allocated to "Tech Trade" and the remaining 50% were to be allocated to the various partners. Note also that the "Strategic Investment Portfolio" profit sharing arrangement also provides (before the 50/50 profit sharing between Tech Trade and the named "partners") that 10% of any profit comes off the top to compensate Tech for "trading expenses" and then a total allocation of only a 2.3% return of invested principal was to be allocated each month to the actual investors who were the source of the funds actually being traded in the "Strategic Investment Portfolio".

See also Exhibit #28 to Vernon Abernethy's Deposition dated June 8, 2004 (a specific "Agreement for Placement of Funds") executed by and between Tech Ltd and the Sterling entity Sterling Alliance Ltd. which also calls for basically a 50/50 split of trading profits between Tech Ltd and Sterling after a) Sterling is first allocated a preferential return of 2% per month from available profits (similar to the preferential return allocated to both New Century and Shasta); and, after b) Tech is allocated 15% of profits to cover Tech's expenses of trading and operations.

[14] See footnote 45, beginning on page 33 for the details of such correspondence from Shimer to Murray.

Teague agreed to perform that verification process each month for the benefit of New Century's investors. Murray apparently agreed to this proposed arrangement but then later objected to sending Tech's original statements across the country to Portland Oregon each month. As a compromise, Shimer asked Teague if she would consent to have a CPA local to Tech's trading operation in Gastonia, North Carolina do the actual on site review of original brokerage statements each month and then forward written verification of Tech's trading performance to her each month for the benefit of New Century's investors.

After some further extended discussion which continued well into May and June of 2001, Murray finally agreed to this proposal. Because Teague had no apparent objection to relying upon trading verification performed by a Certified Public Accountant local to Tech's actual Gastonia trading (provided that she received assurances that the verified numbers would be based upon a review of Tech's *original unaltered brokerage statements*),[15] Shimer was satisfied that this proposal would adequately protect New Century's investors while accommodating Murray's apparent concern about sending original brokerage statements across the country every month.

It became quickly obvious to both Shimer and Firth that funding Murray's Synergy Trading System in any significant way with outside accredited investor funds through Shimer's client New Century would be extremely cumbersome. It was apparent that overseas investors as well as any U.S. based investor would clearly prefer to place funds in a U.S. entity—not through a newly formed Nevis entity. This was true even though Shimer had arranged that all funds forwarded for the benefit of New Century were to be received from investors and forwarded to Tech only by a well respected law firm in Nassau.

Shimer and Firth proposed that a U.S. entity be formed to provide both U.S. and foreign investors with access to the Synergy Trading System. Shasta Capital Associates LLC ("Shasta") was formed in Delaware in early May of 2001 and a New Jersey LLC owned and managed solely by Firth. Firth's company Equity Financial Group, LLC ("Equity") with no previous business history was designated as Shasta's perpetual manager. Shasta's PPM and its Operating Agreement were patterned closely after the documents previously created by Shimer for New Century. Murray agreed to a similar division of trading profits with Shasta as he had agreed to provide to New Century and its prospective investors. To both Shimer and Firth, Murray's

[15] See footnote 45 beginning on page 33.

willingness to consent (after some objection) to that 2% preferential return for the benefit of both New Century (and then later for the benefit of Shasta's investors) indicated that Murray was apparently very confident his Synergy Trading System would continue to generate monthly trading profits significantly greater than just 2% per month.

A separate investment agreement was executed between Shasta and Murray's Delaware corporation Tech Traders, Inc. ("Tech"). At the time, Shimer felt that it was not appropriate for Shasta to execute its investment agreement with a foreign entity (such as Tech Ltd.) that was not doing the actual trading. Murray executed the investment agreement by and between Shasta and Tech without objection.[16]

Shimer concluded that since the separate investment agreements executed by and between Tech Ltd. and New Century and by and between Tech and Shasta strongly favored the members of both New Century and Shasta (in light of that 2% preferential return provision) any trading profits properly allocated to Murray's company Tech or Tech Ltd. by those investment agreements (after that generous preferred profit allocation to investors) were really available (after proper apportionment) to Murray to dispose of as Murray saw fit. If Murray was willing to allocate to Shimer's client Shadetree a part of Tech's trading profits earned by Murray's companies from trading the funds of either New Century or Shasta to eventually solve the past difficulty of Shimer's client Kaivalya that seemed to be a matter solely between Murray and Shadetree.[17]

This logic seemed particularly appropriate since any Tech Ltd. company profits so allocated to Shadetree would (unless withdrawn) remain in trade with Tech and were, therefore, continually at risk of loss. There was technically no guarantee from month to month that any of these funds would continue to grow for the benefit of both Shadetree and perhaps Kaivalya.

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[16] The First Investment Agreement executed by and between Shasta and any of Murray's companies was an investment agreement executed by and between Shasta and Tech. Much later at Murray's request a similar (practically a "mirror" Agreement) was also executed by and between Shasta and Murray's company Tech Ltd. At that later time Shimer had no philosophical objection to accommodating this request by Murray since all funds were sent directly from Shasta to Tech and were never lodged in any offshore account controlled by Tech Ltd. Moreover, both entities Tech and Tech Ltd. were basically controlled by Murray.

[17] See previously cited examples in footnote 13 (pages 10 &11) demonstrating Murray's consistent insistence on receiving basically a 50/50 split with his various fund investors. For that reason Shimer knew that any voluntary allocation by Tech to Shadetree of Tech's trading profits was not going to be a compromise in any way of a further additional possible allocation of trading profit to either New Century or Shasta. Murray was simply not, as a matter of principal, ever going to agree to allocate more than the amount of trading profits he had already agreed to allocate to either New Century or Shasta.

Shimer never tried to hide the existence of his client Shadetree from anyone and in fact had specifically referred to Shadetree in another context in Shasta's original PPM dated June 30, 2001.

The written record clearly shows that by late June, 2001 progress was being made toward implementing independent CPA verification of Tech's trading. Murray initially proposed that Rob Collis ("Collis") of the local North Carolina CPA firm of Collis Wilson & Associates perform the local on site verification of Tech's trading performance each month. Shimer faxed to Teague on June 24, 2001 a 2 page letter which also attached an additional two pages consisting of Shimer's suggestions for what the letter from Collis to Teague might state each month. Since Shimer was not a CPA he envisioned that the verification letter from Collis to Teague would just reflect a simple mathematical calculation necessary to compare the opening account balance found on Tech's brokerage statement(s) with the ending account balance on those same statements taking into proper account any additions or withdrawals that had occurred with respect to Tech's trading account(s) during the month in order to arrive at a proper return on investment number.

Shimer was clearly aware that the two CPA's (Collis and Teague) would probably decide on language other than what he had suggested. Shimer's fax to Teague dated June 24, 2001 stated in part:

> "The exact verbiage in Mr. Collis' letter to you is a matter for the two of you to work out. Whatever he sends you should be a standard letter that you both agree upon. Then all he has to do is simply plug in the appropriate numbers for each consecutive month and send that information to you. It should be a very simple process."

Though Shimer's fax on June 24, 2001 attached a two page suggested text for Collis' proposed letter to Elaine, the record clearly shows that Shimer was fully aware and accepted the fact that the two CPAs (Collis and Teague) would probably ignore whatever language he suggested. Shimer's fax further reflected that clear understanding and expectation on his part:

> "In the interest of providing as much support as possible to both you and Rob, I have enclosed with this fax a two page draft of a sample letter I just prepared that will at least give you both the basis for a beginning discussion. I am sure you will both want to make changes or you may create something totally different but at least my suggested draft can be a starting point for both of you."

The written record further shows that on July 3, 2001 a five page fax from Shimer to Teague (mostly referencing matters with respect to New Century) reflects the fact that the local

CPA originally proposed by Murray had changed. Though Shimer does not specifically identify defendant Abernethy by name in that particular correspondence, Shimer's final paragraph to Teague in that July 3, 2001 fax states in part:

> "I have been told that background information on that CPA will be sent to you. I have also suggested that he call you this week and provide a number and time when you both might have an initial conversation."

Shimer's fax further expressed the fact that Shimer expected to be in North Carolina later in the week of July 3, 2001 and also expressed Shimer's hope "…to stop by and meet this particular CPA personally."

On July 9, 2001 the written record further shows that Shimer followed up after his initial "nice to meet you" meeting with Abernethy in which the conversation centered mostly around politics and golf. Shimer sent Teague a one page fax dated July 9, 2001 after that meeting with Abernethy which stated that he

> "had a chance to meet with both Coyt Murray the head trader and President of Tech Traders as well as the CPA that has agreed to provide initial review of Tech's *original unaltered brokerage statements each month*. I had a chance to meet with this CPA briefly for about half an hour on Friday afternoon and I think you will find him to be very professional and also easy to work with. His name is J. Vernon Abernethy." (Emphasis added)

Shimer then stated that he was sending with that fax to Teague a copy of Abernethy's resume and also following up that fax by sending to Teague a copy of Abernethy's resume by mail. The final paragraph of Shimer's fax to Teague dated July 9, 2001 states as follows:

> "Mr. Abernethy spent some time last week reviewing the actual trading operation of Tech Traders *and also had a chance to review several past statements from the brokerage firm(s) used by Tech Traders to execute trades*. If he has not yet called you, he will shortly. I trust that the two of you will be able to work out the wording of whatever letter of verification will be mailed and faxed to you from his office each month." (Emphasis added)

Contrary to the allegations found in the Plaintiff's First Amended Complaint, the written record shows absolutely no participation at all by Shimer in developing the actual "Agreed Upon Procedures" letter that became the final letter of trading verification faxed regularly by

Abernethy to Teague each month.[18] The written record apparently shows that Abernethy, in a draft letter dated July 5, 2001, originally proposed three unidentified procedures. Shimer was accompanied by Murray and met Abernethy for the first time on Friday July 6, 2001 for a brief introductory meeting where Shimer recalls the conversation basically centered on politics and golf. There was no review or discussion to Shimer's best recollection of Abernethy's July 5th first draft. In a July 19th draft letter sent to Teague Abernethy proposed a draft of six specified "agreed upon procedures." The written record shows that Teague replied to Abernethy in a fax dated July 20, 2001, "I received your fax on agreed upon procedures - this looks good to me." [19]

There is no evidence whatsoever that Abernethy ever provided a copy of his July 19th draft letter to Shimer for his review or comment. The six agreed upon steps or procedures referred to by Abernethy in his correspondence dated July 19, 2001 and evidently sent to Teague for her review and approval clearly did not contain a final version of the eventual wording chosen for Abernethy's "verification letter".[20] Teague's faxed reply to Abernethy dated July 20,

[18] The allegation found in Plaintiff's First Amended Complaint that Shimer played a role in developing the "Agreed Upon Procedures" purportedly applied to Tech's trading verification is based solely upon the sometimes bizarre, erratic and often confused deposition testimony of defendant Abernethy. Abernethy's recollection should be accorded very little if any credibility. For example, Abernethy's testimony about his first meeting with Shimer is clearly not an accurate reflection of the facts. (See Abernethy Deposition transcript for June 8, 2004, page 85 where Abernethy places his initial meeting with Murray and Shimer to be in either "August or September". Clearly Shimer's above cited fax correspondence to Teague dated July 9, 2001 confirms the fact that Shimer's first "nice to meet you meeting" with Abernethy occurred on Friday, July 6, 2001.

Further evidence that the procedures "agreed upon" were clearly not the result of Shimer's input is found in the fact that as a final part of the subscription process, each new member of Shasta was asked to sign and send to Teague confirmation of the fact that each member had executed, as a standard part of the subscription process, a certain document entitled "Agreement for Independent Verification of Shasta Capital Profits and Losses". This confirmation to Teague took the form of a letter from each member of Shasta to Teague after all subscription documents were executed. The very first part of that letter sent by approximately 50 of Shasta's new members to Teague beginning in early 2002 until late 2003 stated, in part, as follows:

> "It is my further understanding that your ability to verify information with respect to the Trading Company is possible as the result of a protocol procedure established between your firm and a certain independent certified public accounting firm located in the local area of the Trading Company."

That Teague never expressed any objection for over 1½ years to this particular statement in a letter being consistently sent to her by Shasta's new members only confirms that she evidently believed the statement to be accurate.

[19] This interchange between Abernethy and Teague is Exhibit #37 to Vernon Abernethy deposition taken on June 9, 2004. All other written correspondence between Shimer and Teague referred to herein and all other documents referred to herein are already in the possession of Plaintiff and can easily be made available to the Court.

[20] The "Agreed Upon Procedures" draft letter faxed to Teague by Abernethy dated July 19, 2001, for example, does not even use the final term "trade sheets" found in final versions of Abernethy's letter actually sent each month to Teague but instead uses the word "report" in enumerated procedure # 1 and also uses the word "report" in enumerated procedure #2 instead of the final term "trade sheets". Also note that in enumerated procedure #2 the

2001 also cites questions for which Teague needs answers from Abernethy.[21] Further correspondence between Teague and Abernethy clearly reflects Teague's concern that she has not yet received from Abernethy "…a copy of the trade sheet that the AUP covers tho".[22]

Moreover Teague clearly communicates to Abernethy in an e-mail dated July 24, 2001 not only the fact that he will be providing to her a verification with respect to Tech's "rate of return" for the benefit of Shimer's clients[23] but also her clear "concern" with respect to "the calculation of the rate and that it is not skewed by additions and withdrawals of monies during the month." The only communication in the record between either Teague or Abernethy and Shimer about the proposed Agreed Upon Procedures is a fax from Teague to Shimer dated July 26, 2001 enclosing a copy of a previous Abernethy draft. There is no indication that Shimer replied in writing to that fax from Teague in any substantive way or that he participated by sending either Abernethy or Teague written comments on what Abernethy's letter should say. The record does not contradict in any way the fact that Shimer's attitude was always that if what Abernethy proposed to send to Teague each month regarding Tech's performance was satisfactory to Teague, then it certainly would be satisfactory to Shimer.

The record further clearly shows that the "rate of return"[24] performance numbers for the Synergy Trading System operated by Tech and regularly forwarded by Abernethy to Teague each month are the exact same "rate of return" performance numbers for the Synergy Trading System that Shimer's client Shasta regularly posted on its web site and that formed the basis for the report issued each month to every Shasta member.

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final version of Abernethy's verification letters faxed regularly to Teague ends the procedures #2 sentence with the phrase "related to the summary of trades" while Abernethy's draft letter faxed to Teague on July 19, 2001 proposes to end that same sentence with the words "related to the report".

[21] Teague states as a question back to Abernethy in her fax dated July 20, 2001: "I will be getting a copy of this letter along w/ the related report each month? What will be the timing?"

[22] Exhibit #38 to Vernon Abernethy Deposition taken on June 9, 2004.

[23] "Our concern is with the rate of return per month…I spoke with Bob Shimer this morning. New Century is anxious to get the process refined to start as of July 31st. He will have investors/potential investors calling @ August 15th to inquire about the returns of the various funds including Tech Traders" (Exhibit #38 referenced in footnote 14 above)

[24] Each monthly trading verification letter provided by Abernethy to Teague specifically used the term "rate of return" when citing a percentage number for that specific month.

On June 30, 2001 Shasta's Private Placement Memorandum was completed. Shimer spent most of the remaining month of July and August preparing for an extended trip overseas. He and his wife left at the end of August and did not arrive back in the United States until the end of September. During this period of time Abernethy was supposed to be actually reviewing and verifying Tech's trading performance beginning with the month of June, 2001. Murray evidently wanted the quarterly period of July, August & September of 2001 to be verified as a quarter rather as individual months. Given the amount of time that it had taken to finally get the CPA verification process on track, Shimer consented to that request by Murray on Shimer's return from overseas but insisted that every month after September, 2001 be separately verified.

Abernethy provided Teague with written verification of Tech's trading performance for every month following the quarterly period ending with September, 2001. Upon receipt of the same from Abernethy, Teague would provide written confirmation to both New Century's manager (Allied) as well as Shasta's manager (Defendant Equity) on a monthly basis. [25]

D. <u>First Receipt of Funds</u>

New Century did not receive its first funds in the amount of $49,500.00 from International Investment Alliance, Ltd. ("IAA") a foreign corporation until November of 2001. In the Spring of 2002 New Century received an additional $100,000.00 investment from Metalchem Metallurgical, Inc ("Metalchem") also a foreign corporation. These are the only two investments ever made with Tech through the entity New Century except that IAA increased its investment by $100,000.00 with New Century in mid May, 2002. Proper due diligence on the source of funds from both of these entities was performed by a reputable law firm in Nassau, Bahamas. All funds invested with New Century for placement with Tech by both IAA and Metalchem were first received by that law firm in Nassau and then transferred directly to Tech's bank account in the U.S. First funds for the domestic entity Shasta were not received by Shasta and forwarded by Shimer from his Citibank attorney escrow account to Tech for trading per Shasta's executed investment agreement with Tech until late January or early February, 2002. [26]

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[25] Plaintiff has absolutely no credible documentation to present to the Court that contradicts in any significant way the facts as stated in this Memorandum to this point in time.

[26] Plaintiff has received full documentation from Shimer and Firth documenting the truthfulness of these facts.

Shimer was so convinced of the bona fides of the trading performance of Tech based upon the continued written performance verification consistently received from Abernethy by Teague and forwarded by Teague to Shasta's manager during all of calendar year 2002 and 2003 that he allowed his wife to invest $150,000.00 with Shasta in September of 2003. That money stayed in trade with Shasta/Tech and was frozen when the Division secured its *Ex Parte* Restraining Order and the appointment of a Receiver in early April of 2004. From October, 2003 until March 2004 Shimer's wife received regular statements from Shasta's manager along with every other member of Shasta.[27]

E. <u>Registration Issues</u>

1. Filing of Regulation D exemption for Shasta

Shimer functioned as the attorney for both Shasta and Equity and in that capacity was responsible for determining what registrations were necessary and for making required filings. Shimer examined these issues in the fall of 2001 and concluded that the sale of membership interests in Shasta solely to fully accredited investors qualified as a private placement under SEC Regulation D. He further determined that Shasta and Equity did not need to register with Plaintiff as either a commodity pool operator (CPO) or as a commodity trading advisor (CTA) because, in his opinion, neither met the specific definition of a CPO or CTA. Shimer had no previous experience with the Commodity Exchange Act or the Commission's regulations.[28]

In 2002 after first funds came into Shasta Shimer prepared for Firth's signature as the controlling person of Shasta's manager an initial Regulation D filing with the SEC. Several additional Reg. D filings were periodically prepared by Shimer, signed by Firth and filed timely with the SEC as appropriate.

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[27] These particular facts are a part of the record and cannot be denied by Plaintiff.

[28] Neither Shimer nor Firth had any prior experience with the CEA or Commission regulations. In 1986 Shimer had taken and passed the Series 3 test in anticipation of possible work in the futures industry but he never worked for the sponsoring firm or for any other commodities or securities registrant. Firth never had any connection with the futures industry but while working from late 1980 to 1982 for a broker dealer passed the Series 7 test necessary for soliciting in the securities industry. Although Firth passed the test, he never utilized his Series 7 license since he worked almost exclusively in the real estate and mortgage business.

2. Necessity of CFTC registration by either Shasta or Equity

a. Shimer's initial good faith conclusion re: CPO and CTA issues confirmed in 2001

In the fall of 2001 a legal colleague of Shimer's requested a Private Placement package from Shasta for one of his institutional clients. Shimer requested Firth to forward Shasta's Private Placement package to that attorney. Shimer later had a three-way telephone conversation with both that particular client and Shimer's legal colleague in which that client raised the question of whether or not registration with the CFTC might be necessary for either Shasta or Equity. Shimer stated that, based upon his previous reading of the CFTC's regulations, registration by Shasta, Shasta's manager Equity or by Tech (identified to the client at that time solely as "The Trading Company") was not necessary. In Shimer's opinion neither of those entities met the definition of a CPO or CTA.

The client expressed concern about that issue. Shimer offered to prepare a memorandum summarizing his conclusions and the basis for those conclusions. Shimer forwarded his memorandum to his legal colleague who passed Shimer's memorandum on to the client for submission to that client's legal department for review. Shimer received a verbal confirmation from his legal colleague several weeks later that, indeed, the client's legal department had, as a courtesy, reviewed the issues presented in Shimer's memorandum and apparently agreed with Shimer's conclusion that neither Shasta nor Equity qualified as a CPO or CTA. No red flag was apparently raised or conveyed to Shimer with respect to Tech's status either.[29] Based upon that unsolicited (but to Shimer's mind useful) confirmation of his initial conclusion, Shimer gave no further consideration to the issue of registration with the CFTC on behalf of either of his clients. Firth reasonably relied on Shimer for advice and guidance on all regulatory matters.

The operation of Shasta commenced in early calendar year 2002 and continued throughout that year and most of 2003 without incident. Shimer and Firth both believed in good faith that all regulatory requirements had been satisfied with respect to Shasta and that Shasta was not required to register with the CFTC. In October of 2003 an individual who purported to be a prospective member of Shasta raised the issue of whether or not Shasta was a Commodity Pool. Shimer was later informed that prospective Shasta member had actually taken it upon

[29] Shimer's legal colleague has indicated to Shimer that he is willing to submit a signed sworn affidavit confirming these facts as basically stated in this Memorandum.

himself to directly contact the CFTC in Washington, D.C. [30]

b. Arnold & Porter retained in fall of 2003

Shimer immediately sought the direct advice of knowledgeable counsel. He called his law school alma mater and was referred to an alumnus in the Washington, D.C. area familiar with securities regulation issues. Shimer immediately contacted that attorney. That attorney referred Shimer to Geoffrey Aronow, ("Aronow") a partner with the law firm of Arnold & Porter in Washington, D.C since the matter in question required expertise with respect to the regulations of the CFTC. Aronow had been the head of the CFTC's Enforcement Division from 1995 to 1999. At that time, Shimer felt that this particular referral to Aronow was an excellent one and that his clients would both be well represented and able to deal with any registration issue or registration requirement that might arise with respect to either Shasta or Equity.

Shimer sent Aronow an e-mail at 1:30 PM on Friday, October 24, 2003 confirming the fact that he was sending Aronow by Federal Express that day for delivery the following Monday Shasta's Private Placement Memorandum (PPM) as well as *all other subscription documents typically sent to a prospective Shasta investor*. Shimer also advised Aronow in that same e-mail that *he would also include a copy of the investment agreement initially executed by and between Shasta and Tech*.

In his e-mail to Aronow on Friday October 24, 2003 Shimer *specifically requested* that Arnold & Porter represent *both Shasta as well as its manager Equity*. Shimer's e-mail requesting representation by Arnold & Porter for both Shasta and Equity described Shasta as a Delaware limited liability company and Equity as a New Jersey limited liability company. All documents promised in Shimer's e-mail to Aronow were sent out to Arnold & Porter by Federal Express on October 24, 2003 (USA Air bill # 842184337087) for delivery that following Monday.

Accompanying those Private Placement documents sent to Aronow was a four page cover letter also dated Friday October 24, 2003 in which Shimer described *in clear detail the entire contractual relationship that existed between his client Shasta and Tech Traders, Inc*. Shimer specifically spent time in his cover letter to Aronow highlighting the fact that the relationship between Shasta and Tech was not a traditional one in which a separate account had been established in Shasta's name for the trading by Tech of Shasta's funds. *Shimer clearly disclosed*

[30] That prospective Shasta investor's name was Mark Munson. The PPM issued by Equity on behalf of Shasta to Munson was attached as an exhibit to Plaintiff's Original Complaint.

to Aronow in his cover letter the fact that all of Shasta's funds were co-mingled with both Tech's funds and the funds of other Tech clients in a "super fund" trading account established in Tech's name only.

Shimer made it *very clear* to Aronow that Shasta's funds were being traded by Tech from an account in Tech's name only. Shimer *never received any indication written, verbal or otherwise from Aronow* that this particular investment arrangement between his client Shasta and Tech a) might itself be a violation of the CFTC's Regulation 4.30, 17 C.F.R. § 4.30 by Tech or that the mere act of drafting the investment agreement that existed between his client Shasta and Tech which allowed for a co-mingling of funds received from Shasta with other Tech client funds or funds belonging to Tech might possibly subject Shimer personally to alleged liability under Section 13(a) of the Commodity Exchange Act, 7 U.S.C. § 13c(a).[31] Nor was Shimer *ever advised* by Aronow that the act of submitting funds to Tech on behalf of Shasta from his attorney escrow account at Citibank might arguably subject Shimer personally to charges of willfully aiding and abetting Equity's alleged violation of Section 4m(1) of the Commodity Exchange Act, thereby making him personally liable under Section 13(a) of the Commodity Exchange Act 7 U.S.C. § 13c(a).[32]

Shimer's cover letter to Aronow dated October 24, 2003 also specifically referred to and enclosed an updated version of the memorandum Shimer had previously prepared in the fall of 2001 when the issue had previously arisen with respect to the question of whether or not either of his clients or Tech met the definition of either a CPO or CTA and were required to register with the CFTC. Shimer's cover letter to Aronow dated October 24, 2004 concluded in part as follows:

> "It seems particularly appropriate for Shasta and its manager Equity to retain the services of your firm at this time to examine this issue closely to provide my clients with a definitive answer with respect to these questions now apparently raised anew. If you agree that no registration or notice filing must occur by either of my clients because they do not engage in the type of activity requiring their registration as either a Commodity Pool Operator or a Commodity Trading Advisor, I would also appreciate an opinion with respect to the activity of Tech as well."

In a separate paragraph in that same cover letter Shimer then continued:

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[31] See First Amended Complaint, Count V, ¶ 104.

[32] See First Amended Complaint, Count III, ¶ 81.

> "I would also seek your assistance in notifying either the NFA or the CFTC if you conclude that any such registration or notification is appropriate or necessary with respect to Shasta, Equity or Tech. If you conclude that registration either as a CTA or CPO is actually necessary or if notice requesting exemption from registration is necessary, *then my clients request your help and assistance in "running interference" with the CFTC by assuring them that any lack of necessary filing or notice was not intentional and that my clients are willing to take any corrective action that might be necessary*." (Emphasis added)

Shimer's cover letter to Aronow included his Citibank attorney escrow check # 1011 in the amount of $8,000.00 as an initial retainer for the representation requested for *both* of his clients Shasta and Equity. Shimer and Firth were never advised in writing or otherwise by Aronow, or anyone else at Arnold & Porter that the nature of Shasta's unique contractual relationship might raise significant registration issues *separate and apart from the registration status of Tech*. Instead Shimer and Firth were consistently advised by both Aronow and Susan Lee ("Lee") (a former chief of Staff at the CFTC now with Arnold & Porter) that Arnold & Porter's advice with respect to Shasta's status *would hinge on Tech's status*. [33]

To Shimer's surprise, he was advised by Aronow and Lee there was a high probability that Tech would be considered to be a Commodity Pool Operator by the CFTC and that registration by Tech would be necessary. *At no time during the entire period of time from late October until April 1, 2004 did Aronow or Lee or anyone else at Arnold & Porter ever advise Shimer or Firth or Shimer's client Shasta that Shasta should cease receiving funds from investors.* This lack of any caution from Aronow and Lee clearly suggested to both Shimer and Firth that as far as Arnold and Porter was concerned, the CFTC would be primarily concerned about a failure to properly register on the part of Tech—*not Shasta or its manager Equity*. Shimer told both Aronow and Lee that it was his understanding that Murray had sought and received previous advice from legal counsel local to the Charlotte, North Carolina area that Tech was exempt from any CFTC registration requirement.

Aronow and Lee advised Shimer to encourage Murray to seek and obtain the advice of experienced legal counsel to review and address this issue. The written record shows that Shimer again and again repeatedly asked Murray to take this suggestion seriously and to secure separate experienced legal counsel. Shimer repeatedly urged Murray in November and December of

[33] Plaintiff has in its possession all documentation confirming not only the quoted portion of Shimer's cover letter to Aronow but also all e-mails sent back and forth between Shimer, Firth, Aronow and Lee.

2003 to take the matter of Tech's registration status seriously and retain separate legal counsel to review the issue of whether or not Tech needed to register with the CFTC.[34] Murray assured Shimer that Tech would register if that was necessary but Murray repeatedly took the position in his conversations with Shimer that it was Murray's understanding that registration by Tech was not necessary because Tech had less than 15 clients and, if Tech was not required to register with the CFTC or the NFA, Murray preferred not to take that step voluntarily.

Arnold & Porter (through Aronow) advised Shimer and Firth in writing during late 2003 and early 2004 that it was infinitely preferable that Shasta contact the CFTC *with Tech*. Aronow apparently felt that such a joint presentation was preferable in light of the fact that if Shasta went in alone to the CFTC to discuss the situation and any possible registration requirement the CFTC's first question would be "Who is Tech and why aren't they here with you?"

Despite this initial advice from Arnold & Porter, on several occasions Shimer (and especially Firth) specifically requested that Arnold & Porter initiate a conversation immediately with the CFTC on Shasta's behalf as time passed and a joint meeting with Tech continued to be delayed. The record further shows that *on two separate occasions* (in December of 2003 and then again in February, 2004) Shimer *specifically requested* and received from Arnold & Porter written memorandums drafted by Lee at the specific request of Shimer *solely for the specific purpose of impressing upon Murray the importance and urgency of a collective meeting with the CFTC per the strategy advised and suggested by Aronow*. Shimer forwarded both of these Memorandums to Murray in the hope of expediting a joint meeting between his clients Shasta and Equity, Tech and the CFTC.[35]

Arnold & Porter advised Shimer and Firth that registration with respect to Shasta probably hinged on whether or not Tech had to register. There was even some discussion between Lee and Firth but especially between Lee and Shimer that if Tech did register as a CPO that *Shasta may not have to register at all*. Shimer was advised by either Lee or Aronow or both that there was a *possibility* that Shasta would merely be considered a "fund of funds" and that exemptive relief might be available with respect to Shasta as a result of the CFTC final rules affecting CPOs and CTAs issued on August 1, 2003. Lee and/or Aronow suggested to Shimer

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[34] Plaintiff certainly has in its possession copies of all correspondence from Shimer to Murray addressing Shimer's continuing and repeated concern that Murray retain responsible and knowledgeable legal counsel to address the issue of whether or not Tech was required to register in any capacity with the CFTC.

[35] Both of these memorandums drafted by Arnold & Porter at Shimer's request are in the possession of Plaintiff.

that such an argument could be made to the CFTC by Arnold & Porter on Shasta's behalf.

Despite Shimer's initial request in both his e-mail and cover letter dated October 24, 2003 to Aronow requesting representation for *both Shasta as well as Shasta's manager Equity* Arnold & Porter *never advised either Shimer or Firth* that Equity (and, therefore, by association, Shimer and Firth) might have separate registration problems or obligations regardless of the registration status of Tech. Firth and Shimer were merely advised that if Tech did not register, a trading ban or fines might be imposed but never were they advised of the possibility that the CFTC might seek the extraordinary remedy of an *Ex Parte* Statutory Restraining Order against them or that the CFTC might seek to impose a fine and penalties upon them personally. Since Shasta was not engaged in trading of any sort, all references by Arnold & Porter to the possibility of a trading ban clearly applied only to Tech. Arnold & Porter never advised Shasta that it would be advisable to stop receiving funds from accredited investors until any possible registration issue was resolved with the CFTC.

Shimer and Firth were advised by Aronow and Lee that the CFTC might request assurances that Shasta would be willing to withdraw all of its funds from Tech if Tech did not comply with registration as required. Shimer and Firth, though obviously hesitant to end what was considered to be an extraordinary and profitable relationship between Shasta and Tech, both indicated a willingness to take whatever action was required by the CFTC. Shimer and Firth were prepared to follow and comply with whatever advice Arnold & Porter rendered and the written record supports that fact as confirmed by Shimer's initial cover letter dated October 24, 2003 and all subsequent e-mail correspondence between Shimer, Firth, Aronow and Lee.

F. CFTC "Investigation" of Shasta

The CFTC apparently began its investigation of Shasta sometime after October of 2003 following a direct inquiry it had received from a prospective member of Shasta. The Division's "investigation" was extraordinary not only for what it missed but the apparent willingness on the part of the Division to draw unwarranted conclusions about the Equity Defendants while studiously ignoring any and all contact with *anyone* who might provide basic information highly relevant to a proper and even marginally sound investigation of Shasta. The Commission *clearly knew* that Shimer's client Shasta had retained Puttman & Teague as its CPA firm *because the person who contacted the CFTC in October of 2003 about Shasta had literally spent hours on*

the phone with Elaine Teague during the months of September and then in October, 2003 seeking more information than provided in Shasta's subscription documents about the local CPA who performed the actual trading verification (Abernethy) and the specific procedures that clearly Teague, Shimer and Firth all believed in good faith were being followed by that local CPA to ensure reliable verification of Tech's trading performance.

Moreover the Division had clear constructive if not actual notice that Shasta had previously retained Arnold & Porter as legal counsel because that fact was clearly posted on the Hedgeco web site. That particular web site by Hedgeco was specifically cited not less than twice in the Division's Original Complaint.[36] By deliberately choosing not to initiate any contact with either Arnold & Porter, Puttman & Teague or any of the Equity Defendants during the course of its "investigation" the Division imposed intentional blinders upon itself, assuring the absence of basic, essential and critical facts that would have otherwise been obvious with respect to both the operation of Shasta and the good faith of all of the Equity Defendants.

G. Filing of Current Action by Plaintiff

As a result of this decision by the Division to basically conduct an "investigation" of Shasta without the benefit of essential and critically important facts Plaintiff's Original Complaint filed with the Court on April 1, 2004 accomplished the astoundingly inept feat of: (a) failing to name Coyt E. Murray the head trader and President of defendant Tech who received all funds from Shasta and every other victim of this apparent fraud; (b) failing to name J. Vernon Abernethy, (the local CPA who has admitted under oath during his deposition that he failed to perform the "Agreed Upon Procedures" he consistently referred to every month when forwarding his performance verification letter to Shasta's CPA; and (c) failing to name all but one of the family of companies set up by Murray to pull off what now appears to be a massive Ponzi scheme to the detriment of Shasta's members, Shimer, Firth and Shasta's manager Equity and a whole host of other individuals and entities—many still unknown to both Shimer and Firth.

In addition, the Division apparently compounded an initially incomplete investigation by failing for several critical months after the filing of the Original Complaint on April 1, 2004 (and as far as the Equity Defendants know the Division has failed even to this day) to take what any reasonable person would consider to be absolutely critical action to preserve and protect the

[36] See ¶ 23 on Page 8 of Plaintiff's Original Complaint. See also ¶ 26 on Page 9 of Plaintiff's Original Complaint.

interests of Shasta's investors and all other investors with Murray and Tech by freezing not only any and all personal bank accounts of Murray and Abernethy, but also the bank accounts of *any and all members of Murray's family and any and all employees of Tech who may have participated in any possible way in the continuation of Murray's apparent fraudulent trading scheme*.

Instead, the Division chose to initially focus on and freeze the bank accounts of Shimer, Firth (and the bank accounts of Firth's children that only contained several thousand dollars). Watching the Division's performance throughout this entire "investigation" is like falling down the rabbit hole and being literally forced to attend the Mad Hatter's tea party. *Nor is this the first time the CFTC has inspired a comparison to Alice's Adventures in Wonderland*.[37]

In addition to the above cited incredible oversights, the Division's initial investigation resulted in an Original Complaint against the Equity Defendants replete with factual errors, incorrect assumptions and erroneous conclusions about all of the Equity Defendants.[38] The

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[37] See *New York Currency Research Corp v. CFTC* 180 F. 3d 83 (2nd Cir 1999) at 85 where the Second Circuit Court of Appeals concluded, (upon initial review of the CFTC's interactions with Appellant) that the CFTC had virtually ignored its own rules and moved to an expedited procedure against Appellant which (according to the Appellate Court) "fulfilled no public interest that we can see". The CFTC's actions prompted Circuit Judge Cardamone to observe: "Certain aspects of this case have an Alice in Wonderland quality about them." The Court, then directly citing to the Lewis Carroll novel, further stated "the Commission appears to have acted the role of the Queen who declared in a similar fit of pique during the hurried trial of the Knave of Hearts, "Sentence first--verdict afterwards." Lewis Carroll, Alice's Adventures in Wonderland 156 (Justin Todd illus., Crown Publishers 1984)." (*New York Currency* at 85).

[38] **One apparent and glaring deliberate misrepresentation by Plaintiff in its Original Complaint filed as a basis for the Restraining Order and Preliminary Injunction stands out and might be of *particular concern* to the Court and arguably merits further "explanation" by Plaintiff. In ¶ 28 of the Original Complaint Plaintiff specifically alleges that "Shimer accepted deposits totaling over $14.9 million" (into his escrow account for the benefit of Shasta) and then in the immediate following ¶ 29 Plaintiff alleges that "Since February, 2002 at least $9.6 million has been transferred from Shimer's escrow account to Tech Traders." Based upon the banking records clearly available to the Division as a part of its "investigation", Plaintiff clearly knew or should have known that this cleverly implied $5.3 million "discrepancy" between the alleged amount of funds *received* by Shimer and the amount alleged to have been *forwarded* by Shimer to Tech did not exist. Yet the Division's employees, in a very cleverly worded way, inserted this "apparent funds discrepancy" into Plaintiff's Original Complaint to lead the court to the false conclusion that Shimer was not forwarding all "required funds" to Tech. This, of course, was clearly not true. This deliberate implication found in Plaintiff's Original Complaint was arguably either an intentionally fabricated falsehood or, at the very least, a falsehood inserted with reckless disregard for the truth. *The banking records available to Plaintiff clearly showed there was absolutely no such "$5.3 million discrepancy"*. Any federal employee, acting under the authority of enforcement power of a federal Agency pursuant to authority conferred by Congress should be severely sanctioned for deliberately or, at the very least, recklessly inserting false "alleged facts" into a document filed with a Federal Court as a way to "bolster" that agency's alleged basis for seeking an extraordinary statutory remedy against private citizens.**

Division's First Amended Complaint dated June 24, 2004 simply continues that tradition with unrelenting and apparent zeal.[39] The Division's apparent tactic now is to conjure up and search for whatever it possibly can--particularly with respect to Shimer. In pursuit of that apparent strategy the Division has recently subpoenaed the banking records for the joint bank account of Defendant Shimer and his wife seeking private banking records *going back 3 years before the time that any funds from his client Shasta were ever placed for trading with Tech!*

And yet in spite of the Division's request for "expedited" discovery the critical depositions of Shimer and Shasta's CPA Teague have yet to be taken by Plaintiff *a full year after the commencement of this action!* The sheer magnitude of the injustice perpetrated against both Shimer and Firth by the Division is beyond belief and truly extraordinary.

Shimer and Firth clearly recognize there was a need on the part of the Division to take quick action in light of the significant amount of funds received and dissipated or lost in trade by Murray and Tech. Shimer and Firth further recognize and appreciate the fact that this matter has become far more complicated for both the Court appointed Receiver and the Division in light of the extensive investment with Tech and Murray by a variety of Sterling entities and an apparent host of other individuals and business entities (unknown to and unrelated to either Firth or Shimer) equally victimized by defendant Abernethy's obscenely inaccurate "trading verification" that clearly benefited Murray's alleged ponzi activities. With respect to defendants Shimer, Firth and Equity the Division's behavior in this entire matter, unfortunately, is like watching a wild wind up toy go completely out of control.

In truth the present action (while certainly necessary to halt the apparent fraudulent activities of Tech and Murray) is a near perfect example of why private citizens have so much to fear from their own government. Defendant Firth, though always acting only in good faith with respect to Shasta, and with no knowledge whatsoever of Tech's trading losses suddenly found armed U.S. Marshals at his front door perfectly willing to literally break it down as if he were a common criminal if he was not willing to immediately let them enter and seize not just his

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[39] Other than the very disturbing falsehood referred to in footnote 38, Shimer and Firth see no need to extend the length of this Brief recounting in detail every single factual misstatement and bit of wrong information found in both the Original as well as the First Amended Complaint but assure the Court that a complete recounting would, indeed, add many more additional pages to this Brief. Even more incredible is the fact that (like the blind man who, before regaining his sight declared with great confidence upon grabbing its tail that an elephant was "much like a rope") Plaintiff, evidently realizing they "got it wrong" the first time, decided the best tactic would be insert in its First Amended Complaint even more new disparaging "facts" (especially about Defendant Shimer) which were just as untrue, poorly researched and incomplete as most of the information offered in Plaintiff's Original Complaint!

computers and Shasta related paperwork but all of his personal files and other business files completely unrelated to Shasta.

All of Firth's files were then held for an extended and unreasonable period of time and finally returned in such a rifled and disgraceful disarray that it would literally take weeks for Firth to re-assemble his paperwork and files into any proper order.[40] The level of disrespect and official arrogance shown to both Shimer and Firth in this matter is not only alarming but absolutely disgraceful and inexcusable. All of this simply because employees of the Division, with great zeal and "authority" had put on their blinders and assumed the worst with respect to Shimer and Firth when the factual landscape was obviously replete (for anyone who cared to look) with evidence pointing to exactly the opposite conclusion.

The grievous and simply inexcusable omission by the Division with respect to both Murray, Murray's companies other than Tech and Abernethy was not corrected until a First Amended Complaint was filed on June 24, 2004—*almost three months after the filing of the initial Complaint!* The effect of this glaring and inexcusable omission was that Shimer and Firth were forced to bear the brunt of the Division's charges, had all of their assets and bank accounts frozen and were stigmatized by the Division's damaging allegation that they had knowingly engaged in fraudulent conduct. The Division's apparent continuing "plan of action" now seems to simply try and "look for whatever else they possibly can" to somehow justify its initial outrageous requirement of armed marshalls respect to Firth.

This seeming unwillingness on the part of the Division's employees to recognize, acknowledge and correct their countless original factual mistakes has been to simply compound the devastating financial impact and consequences on both Shimer and Firth of both Murray's fraudulent conduct and Abernethy's inexcusable negligence and failure to do what Abernethy continually represented in writing on his letterhead and forwarded every month to Shasta's CPA. Despite the fact that Shasta's CPA Teague received the continuous performance verifications from Abernethy without ever expressing any concern written or otherwise to either Shimer or Firth about the sufficiency of the trading verification procedure implemented to protect Shasta's investors,[41] the Division has apparently concluded in its "infinite wisdom" that charges of fraud

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[40] Firth is more than happy to provide the Court with a sworn affidavit confirming the truth of this description of what happened.

[41] This "fact" is absolutely indisputable by Plaintiff.

should be leveled (first against Firth in the Original Complaint) and later against both Shimer and Firth in the First Amended Complaint simply because "some how" and in "some way" they "should have known" something was wrong! If only the presiding deity of our current universe had conferred on all other mortals the unique ability of the Division's employees to view events as they happen with such convenient 20/20 hindsight.

The Division has, in a most discriminatory fashion, brought a lawsuit of outstanding questionable merit against Shimer, Firth and Equity. The conduct of the Equity Defendants is clearly peripheral to the fraudulent conduct in this matter and the defenses available to Shimer, Firth and Equity appear to be substantial.

III. WITH RESPECT TO COUNT I OF PLAINTIFF'S AMENDED COMPLAINT

A. Lack of Scienter Precludes Section 4b(a)(2) Liability With Respect to Shimer, Firth and Equity

1. Plaintiff's allegation

Section 4b(a)(2), [7 U.S.C. §§ 6b(a)(2)] is the CEA's general antifraud provision which provides, in pertinent part, that

> "[i]t shall be unlawful… 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 ... (i) to cheat or defraud or attempt to cheat or defraud such other person....".

According to the Division, the Equity Defendants allegedly violated Section 4b(a)(2) of the Act by "misrepresenting the performance of the commodity pool" (Amended Complaint, ¶57). All "other misrepresentations and omissions" conjured up by the CFTC in its complaint to "bolster" its allegation of Section 4b(a)(2) liability, when viewed standing alone are relatively de minimis in the absence of the obvious variance between Tech's actual performance and the performance numbers reported to Equity each month by Shasta's CPA.[42] All other cited "misrepresentations

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[42] The Plaintiff can not contend with any credibility that failure on the part of Firth to disclose to Shimer that Firth had previously been forced to declare bankruptcy for protection back in 1992 (9 years before Shasta was even formed) as the result of a golf course investment that went bad because of the actions of one of Firth's investment partners (a fact that could have easily been disclosed and explained to prospective Shasta investors) provided a justification for Plaintiff's *Ex Parte* Request for a Statutory Restraining Order against Shimer or Firth.

and omissions" (again in the absence of the obvious apparent variance between Tech's actual performance and the performance numbers reported to Equity each month by Shasta's CPA) were not "deceptive", lacked scienter and were not material to a decision to invest in Shasta (see *CFTC v. R.J. Fitzgerald* 310 F.3 1321 (11th Cir. 2002). [43]

Setting aside for the moment the issue of whether or not Shasta is a "commodity pool" under the Commission's own regulations and pertinent case law, the case law previously cited by the CFTC in its original brief in support of Plaintiff's Motion For *Ex Parte* Statutory Restraining Order and Preliminary Injunction (hereinafter "Brief") supports a finding by this Court that the Equity Defendnats *did not* violate Section 4b(a)(2) of the Act.

2. Requirements of case law

For its theory of Section 4b(a)(2) liability the Division first cites in its brief *CFTC v. R.J. Fitzgerald* 310 F.3 1321 (11th Cir. 2002). In that case the court held that in order to establish liability for fraud, the CFTC has the burden of proving three elements: (1) the making of a misrepresentation, misleading statement, or a deceptive omission; (2) scienter; and (3) materiality. See *Hammond v. Smith Barney Harris Upham & Co*., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) 24,617 (CFTC Mar.1, 1990); *CFTC v. Trinity Finan. Group, Inc*., Comm Fut. L. Rep. 27,179 (S.D. Fla. Sept. 29, 1997), aff'd in relevant part, *CFTC v. Sidoti*, 178 F.3d 1132 (11th Cir. 1999). Failure to establish any one of these elements is dispositive and precludes any finding of Section 4b(a)(2) fraud or deception..

While it is true that the performance numbers reported on Shasta's web site were not an accurate representation of Tech's trading performance, the required and necessary element of scienter is clearly missing for any finding of Section 4b(a)(2) fraud with respect to Shimer, Firth and Equity. Fitzgerald further held with respect to scienter that for purposes of fraud or deceit in an enforcement action, scienter is established *if Defendant intended to defraud, manipulate, or deceive, or if Defendant's conduct represents an extreme departure from the standards of*

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[43] Nor can anyone contend with any credibility that the other cited and relatively minor "omissions" in Shasta's PPM alleged by Plaintiff to be "material", would have dissuaded *anyone* from investing in Shasta had these "omissions" been properly disclosed and explained in the absence of the obvious and critically important variance between the actual trading performance of Murray's Synergy Trading System and the trading performance verified by Abernethy and forwarded by Abernethy to Shasta's CPA Teague every month.

ordinary care (emphasis added) (citing *Messer v. E.F. Hutton & Co*., 847 F.2d 673, 677-79 (11th Cir. 1988).

3. There are no facts in the record that support a finding that either Shimer or Firth knew that Tech's actual trading performance did not match the performance verified by Abernethy

There is not a shred of evidence in the record (nor can the Division produce any such evidence) that Shimer or Firth knew that Tech's performance numbers reported by Defendant Equity to Shasta's members were not accurate. The fact that Shimer allowed his wife to invest $150,000.00 in Shasta in September of 2003, and that she received reports like every other member of Shasta and never withdrew any of those funds from the time of that investment until April 1, 2004 when the Division's enforcement action began is strong compelling evidence that Shimer believed Tech's performance numbers were being reported accurately.

4. The facts do not support a finding that Shimer and Firth "should have "known"

a. The experience of Edgar Holding Group, Inc

Nor do the facts support a finding by this Court that any of the Equity Defendants "should have known" that the return on investment figures being forwarded on a regular monthly basis to Equity by Teague were wrong. First of all, Shimer had loaned $150,000.00 of his own funds to the corporate entity Edgar Holding Group, Inc. ("Edgar") and those funds had been placed with Murray's company for trading in January of 2001. The performance numbers regularly reported by Abernethy to Teague were consistent and in line with the performance numbers Murray had provided to Shimer with respect to Edgar's funds prior to the time CPA verification was established. Moreover, Edgar received back its initial investment in several increments always without objection from Murray.

b. The meticulous efforts of Shimer to implement accurate trade performance verification

But significantly more important than Shimer and Firth's prior experience with Edgar's funds placed with Murray *is the verification procedure Shimer meticulously insisted upon to ensure true and accurate reporting of performance numbers for his clients New Century and Shasta*. Shimer and Firth had no reason to doubt that Abernethy was reviewing Tech's original brokerage statements as Shimer had acknowledged to be his understanding in correspondence

from Shimer to Teague[44] but also in correspondence from Shimer to Murray in which Shimer again and again emphasized and reiterated to Murray the important and critical role of Tech's original unaltered brokerage statements in constructing a viable and reliable procedure for CPA verification of Tech's trading performance.[45] Moreover, the fact that Shimer's telephone

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[44] See relevant quotes from correspondence from Shimer to Teague previously referred to on pages 14 &15 of this Memorandum.

[45] • Shimer first proposed the use of an "objective, independent reliable discrete third party" to verify Tech's trading results in a fax to Murray dated March 1, 2001. At that time Shimer proposed that Teague be allowed to receive for her review and verification "a copy (of) the statement of trading activity for TECH's pooled trading account."

• Shimer followed up on March 15th with another fax to Murray about Shimer's proposal for independent verification.

• Shimer again faxed Murray on March 22, 2001 following up with respect to the "independent verification "issue and again expressing the importance of "independent, reliable verification of results we report to investors."

• Shimer faxed Murray again on March 23, 2001 advising him that Teague was "**happy to act as an independent "verifier" of Tech's profitability each month. Her only request is that Tech's brokerage firm send a duplicate copy of its monthly statement to Tech directly to her at her office**." (Emphasis added).

• Shimer faxed Murray on May 23, 2001 stating in part "all this project needs is…the CPA actually getting regular monthly copies of your brokerage account statements for trading by Tech Traders…"

• Shimer faxed Murray on June 22, 2001 advising Murray **"I just spoke with Elaine Teague of Puttman & Teague in Portland Oregon. She is perfectly willing to work with Rob Collis and have him first receive the monthly statement from the brokerage firm."** (Emphasis added) Shimer's fax to Murray also stated: "**As long as he is willing to verify to her that he has indeed seen a true unaltered original copy of the brokerage statement, I don't think she will care whether it comes directly to him from the brokerage firm or whether you deliver it to him after your 24 hour review**." (Emphasis added). Shimer's fax dated June 22, 2001 also provided Murray with Teague's phone and fax number and said "See if you can get Rob to call her on Monday and they can discuss the verification procedure that will occur between them for Tech's monthly trading."

• Shimer faxed Murray again on June 25, 2001 stating "At the risk of overloading your fax with paper, I wanted you to have a copy of my letter faxed this weekend to Elaine Teague, the CPA in Portland who will provide telephone verification to each investor when she receives the numbers each month from Rob Collis." In a second paragraph Shimer further stated: "Also enclosed is a draft that may be of help to both CPA's in coming up with a standard letter which simply allows Rob to plug in the appropriate numbers when reporting and verifying them to Elaine each month. I wanted you to have a copy of this draft so you can see the text of what I have suggested. ***I don't want any more miscommunication—particularly on the issue of CPA verification***. Hopefully Rob will call Elaine today or at least this week to iron out an acceptable form for correspondence each month between them. I faxed you Elaine's office phone number on Friday." (emphasis added)

• Shimer faxed Murray on July 2, 2001 expressing frustration that nothing seemed to be happening with respect to putting CPA verification in place. Shimer stated in part: "I thought we all agreed when we met in March that CPA verification was going to be put in place".

• Shimer faxed Murray again on August 14, 2001 stating in part: "Have you discussed having Vernon do a verification for both June and July? It is very important to start this verification process."

• Shimer's fax to Murray dated October 4, 2001 after his return from overseas states in part: "There are several groups really waiting to receive confirmation from us that the process of verifying your monthly numbers has started." In a following paragraph Shimer stated: "I just spoke to Vernon by telephone this morning and he is ready to come into your office any time and provide Elaine Teague, the Portland CPA, with verification of Tech's numbers for June, July and August."

• Shimer faxed Murray on October 15, 2001 and yet again referred to the fact that verification had not yet happened: "Please let me know if next Friday would work for you and if you think that it would be possible for Vernon to get in there—perhaps the beginning or the middle of the next week to do his verification of the trading result numbers for those first 4 months."

Shimer's faxes to Teague on this subject have been described and discussed previously. (See pages 14 & 15).

conversation with Teague referred to in Shimer's fax of March 23, 2001 to Murray (see highlighted relevant quote in footnote 45, bottom of previous page) clearly advises Murray of the fact that Teague was willing to undertake Tech trading performance verification herself *only if original unaltered brokerage statements were made available to her by Tech's brokerage firm directly*.

Moreover Shimer's fax to Murray dated June 22, 2001 (see highlighted relevant verbatim quote from that fax to Murray also in footnote 45, bottom of previous page) was *direct further notice* to Murray (as well as additional confirmation to Shimer as a result of his referenced telephone conversation with Teague) that Teague was willing to accept (on behalf of her client Shasta) trading performance verification from a CPA local to Tech's trading operation but *only as long as that verification was based upon a review of original brokerage statement*s.

It was, therefore, reasonable for Shimer to assume without any doubt that Teague would apply the exact same requirement to Abernethy when he was soon thereafter substituted for Rob Collis (at Murray's suggestion) to be the local independent CPA to verify Tech's trading performance. It is highly unlikely that Teague would have failed to clearly communicate that critical and important requirement directly to Abernethy as a part of any verbal communication between Teague and Abernethy during the month of July of 2001.[46] Any attempt by Abernethy to contend otherwise is simply not credible.[47]

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[46] But, of course, any such direct confirmation from Teague is noticeably lacking from the record only because the CFTC has yet to take Teague's deposition even though she played a critical role in the verification procedure and obviously has a significant amount of information to add to the record.

It was clearly Teague's understanding and expectation that Abernethy was truly reviewing original brokerage statements of Tech as a part of the verification process because she had received a copy of Shasta's original PPM dated June 30, 2001 which clearly required such a review (See Exhibit #54 to Vernon Abernethy deposition taken July 1, 2004, Page 18 under the subparagraph heading "Trading Company Verification" which specifically requires that Teague, as Shasta's CPA, "receive direct verification from another accounting firm located near the Trading Company that an original unaltered copy of the Trading Company's brokerage firm statement for the month in question, was duly examined for the purpose of determining the applicable profit or loss for the month…"

[47] It would be difficult for any reasonable person to review the text of Abernethy's deposition taken by the CFTC on June 8th and 9th, 2004 and again on July 1, 2004 and conclude that *anything* Abernethy has to say with respect to his role or anyone else's substantive role in this matter has very much credibility.

c. Trading verification by Abernethy required only simple math skills

Nor did Shimer and Firth have any reason at the time to doubt CPA Abernethy's ability to perform the simple mathematical calculations required to produce a verified "return on investment" number each month for trading after a review of Tech's original brokerage statements.[48] Abernethy's resume appeared to be excellent (he was a former member of the North Carolina house of representatives) and his previous experience with the securities industry as stated on his resume gave further weight to the eminently reasonable conclusion that, as a CPA, Abernethy was fully capable of reading a monthly account statement generated by a brokerage firm, finding the opening account balance and also locating the ending account balance.[49]

That Abernethy well knew what was expected of him is clearly established by the simple fact that he specifically referred many times to the Shasta/Tech Investment Agreement and often specifically to the "Profit" paragraph (Paragraph V) of that Agreement during his deposition..[50]

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[48] The actual calculation that was supposed to be conducted to arrive at an accurate profit or loss percentage for any given month was specifically detailed in the Investment Agreement executed by and between Shasta and Tech and it was sufficiently simple that an intelligent 6th grader could probably have done the necessary math. Paragraph V found on page 3 of the Investment Agreement signed between Shasta and Tech went to great lengths to specify exactly how profit (or loss) was to be computed as a result of the CPA review of Tech's trading account(s). The computation required simply subtracting the beginning balance from the ending balance (after making appropriate adjustments for new funds deposited and funds that were withdrawn during the month).

Anyone with a basic math background (an intelligent 6th grader) would know that an adjustment for any new funds that might have come into the account during the month *should be subtracted from the amount of that account's ending balance because they were not available at the beginning of the month and were not included in the opening account balance*. Similarly, funds withdrawn during the month *should be added back to the ending account balance since they were obviously included in the opening account balance*. As a result of these simple necessary adjustments, if the ending account balance was then greater than the beginning account balance the amount that the ending amount exceeded the beginning account balance represented an increase in the account as a result of trading activity (profit). If the ending trading account balance (after these obviously necessary adjustments) was smaller than the opening trading account balance the difference represented a decrease in the account as a result of trading activity (a loss). The amount of profit or loss expressed as a percentage was easily computed by simply dividing the difference between the opening trading account balance and the ending trading account balance by the amount of the opening account balance.

The CFTC's allegations in its Complaint that Shimer and Firth "knew or should have known" that a Certified Public Accountant such as Abernethy would need some sort of "special knowledge" about commodity trading to simply examine a monthly account statement and compare the opening and ending account balances is not only ridiculous—it is completely disingenuous and absurd.

[49] Abernethy's resume listed him as a founder of a company named Capital Choice Financial Services which Abernethy described on page 17 of his deposition dated June 8, 2004 as being a company that "sells insurance and securities". Moreover Abernethy also confirmed in that same deposition on page 25 that he holds a Series 6 license.

[50] See, for example, pages 66 & 67; pages 77-78; page 119; pages 120 & 121; pages 132-134 and pages 144-145 of deposition of Vernon Abernethy dated June 8, 2004;

Nor can defendant Abernethy claim with any credibility he did not know that he was supposed to review Tech's "original unaltered brokerage statements" each month in order to perform the necessary performance verification calculations specified in Paragraph V of the Shasta/Tech investment agreement.[51]

d. Tech returns as "verified" by Abernethy were achieved by other funds known to Shimer and Firth

While the alleged returns being reported by Tech to Shasta each month and separately verified by Abernethy through Teague were considerable, they were not above returns that hedge

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[51] Paragraph XII of the Shasta/Tech Investment begins at the bottom of page 6 of the Agreement and continues on to page 7 is specifically entitled "Independent Verification". That Paragraph begins as follows: "To ensure the highest degree of professionalism and to enable Shasta to represent honestly and accurately to its Members that the account statement numbers provided to Shasta by Tech are correct, **Tech shall provide an original unaltered copy (copies) of monthly statement(s) received from its brokerage firm(s) to an independent certified public accounting firm or independent certified public accountant in the United States acceptable to both Shasta and Tech**. That certified public accountant or firm shall examine the beginning and ending account balance of Tech's account statement(s) for the month and shall verify by letter the percentage of Tech's profit and/or loss each month to another independent Certified Public accounting firm chosen by Shasta willing, in turn, to verify those same percentages to Shasta and its investors." (Emphasis added)

Moreover Paragraph XII of the Shasta/Tech Investment Agreement specifically referred to the computation for determining profit (or loss) as described in Paragraph V: "This percent of profit realized shall have been derived in accordance with the procedure outlined in Paragraph V above". In light of his previous deposition testimony and his numerous references to the Shasta/Tech Investment Agreement, it is virtually impossible for defendant Abernethy to claim with any credibility that he did not clearly know what was expected from him each month with respect to independent verification of Tech's trading performance.

See also Shimer's e-mail sent to Abernethy on March 23, 2002 at 3:20 PM (CFTC Exhibit 43, Abernethy deposition dated June 9, 2004) in which Shimer *twice* specifically refers to the fact that Vernon was supposed to be reviewing Tech's brokerage statements as a part of the verification process. Shimer's second reference to this well founded assumption on his part states in paragraph 8 of his e-mail (in the context of the proposed Shasta balance verification): "You would only verify based upon the original brokerage statements that you reviewed…"

See also Exhibit # 54 to Abernethy deposition taken July 1, 2004 which includes a copy of Shasta's PPM dated June 30, 2001 sent to Abernethy by Firth *months before any funds were received by Shasta and at just about the time that Abernethy actually began providing written verification of Tech's performance numbers to Teague*. That particular PPM which is included as a part of Exhibit #54 bears Abernethy's name and is numbered 11. Under the main topic heading "Independent Verification Of Hedge Fund and Trading Company Profits" and more specifically on page 18 under the sub heading "Trading Company Verification" the following critical and significant information was provided to Abernethy and received by Abernethy without apparent objection or comment to either Teague, Shimer or Firth:

> "The Manager of the Company shall choose and employ at the Company's sole expense the same outside Certified Public Accounting firm (clearly known by Abernethy to be Teague) for the purpose of verifying the profitability of the Company's investment with the Trading Company. Each month this accounting firm shall receive direct verification from another accounting firm located near the Trading Company (clearly Abernethy) that *an original unaltered copy of the Trading Company's brokerage firm statement for the month in question*, was duly examined for the purpose of determining the applicable profit or loss for the month expressed as a percentage of the Trading Company's opening account balance at the beginning of the month." (Emphasis added).

funds are able to achieve from time to time.[52] Moreover the fact that two CPAs literally stood between Shasta and Tech and the fact that Shasta's CPA Teague obviously considered the six specific "agreed upon procedures" cited by Abernethy each month in the performance verification letters she received from Abernethy to be sufficient for the verification purpose intended gave Shimer and Firth further confidence and a clear reasonable basis for concluding that, though admittedly impressive, the performance numbers being reported by Tech and verified by Abernethy were accurate. The facts of this case clearly do not support a finding of anything *even close* to an "extreme departure from the standards of ordinary care".

Additionally, Tech had at its disposal computer equipment capable of performing powerful mathematical computations. Shimer and Firth had been present during trading by Murray on many occasions and had received from Murray substantial documentation and explanation of what appeared to be a very sophisticated trading system being used by Tech and developed by Murray and his son Lex.

5. Discussion Of Other Case Law Cited By Plaintiff

a. *Slusser v. CFTC*

Slusser v. CFTC 210 F.3d 783 (7th Cir. 2002) is not at all dispositive or helpful to the Division with respect to the alleged Section 4b(a)(2) violation by the Equity Defendants. In that case the Defendant Slusser attempted to claim (among other colorful and creative arguments) despite the many cited instances of flagrant and obvious fraudulent conduct on Slusser's part cited by the Court of Appeals, that he was "not culpable, because none of these persons testified that he relied on Slusser's statements--and reliance is an element of fraud." Rejecting that particular argument the Appellate Court found that "Slusser made (or caused to be made) many

[52] It is completely disingenuous for the Division to try to argue that Tech's reported performance numbers alone were a sufficient basis to alert Shimer or Firth to the fact that something might be wrong with the verification process being conducted by Abernethy. A quick review of the EDGAR reporting system found on the SEC's web site reveals that an SB-2 filing dated July 6, 2001 *for just one of the Commodity Trading Advisors and/or CPO's previously referred to in the first version of Shasta's PPM* dated June 30, 2001 shows a yearly performance number for one of the various funds under management by that particular CTA/CPO to be 258.02% for the year 2000! Moreover that reported yearly performance number for calendar year 2000 was the result of the following monthly performance numbers reported during that year: For February 2000: 18.75%; For March, 2000: 47.77%; For April, 2000: 52.11%; For July, 2000: 9.60%; For November, 2000: 15.50%; and for December, 2000: 10.84%. That same SB-2 filing reflects a return for that same fund in the month of January, 2001 of 10.40%.
A separate pooled fund managed by the same group and reflected on the same SB-2 filing shows a return for calendar year 2001 of 181.48%; for calendar year 1998: 293.08%; and for calendar year 1996: 93.05%.
And two other separate pool funds also managed by that same group and reflected on that same SB-2 filing show a return for calendar year 1996 of 157.19% and 105.56% respectively!

false statements; these may be condemned under sec. 4b(a)(ii) and (iii) without proof of reliance even if the CFTC did not establish all elements of common-law "fraud."" All of the other cases cited by the Division in its previous Brief in support of its *Ex Parte* Statutory Restraining Order with respect to the issue of materiality are not helpful to the Division's position and are literally irrelevant in the absence of the required and missing element of scienter.

b. *Haltmier*

The other cases previously cited by the Division with respect to the issue of scienter are similarly not helpful to the Division's position. The Division tries, for example, to cite *Haltmier* for the bold proposition that acting "deliberately" alone is sufficient to establish scienter. *Haltmier v. CFTC*, 554 F.2d 556 (2nd Cir. 1977) was a case in which the court agreed with the Commission's conclusion that petitioner, deliberately and intentionally, undertook numerous unauthorized trading transactions for a client's account, knowing them to be unauthorized, but hoping that they would turn out profitably and thus pass muster with the client. The wrongful acts (unauthorized trading of a client account) were found to have been undertaken with the clear knowledge that the transactions were not authorized.

B. The Mere Fact That Equity Received And Reported Wrong Trading Performance By Tech Is Not Sufficient As A Matter Of Law To Establish The Requisite Scienter To Sustain The Alleged Violation of 4b(a)(2) by the Equity Defendants And Summary Judgment is Appropriate.

Plaintiff CFTC has alleged a violation of Section 4b(a)(2), 7 U.S.C. § 6b(a)(2), on the part of Shimer, Firth and Equity based on an incomplete investigation that missed all critically relevant and important facts which clearly support the obvious and reasonable conclusion that Shimer and Firth did not have any reason to believe that Tech's trading performance numbers reported to defendant Equity by Teague were wrong or incorrect *in any way*. Plaintiff repeatedly refers to the obvious apparent discrepancy between Tech's actual trading performance and Tech's trading performance conveyed from Abernethy to Teague each month but that fact alone (repeatedly cited again and again by Plaintiff) is hardly sufficient to sustain an allegation of Section 4b(a)(2) fraud.

Plaintiff cannot offer to the Court *any substantial or credible evidence* to refute the *overwhelming evidence of the good faith and lack of scienter on the part of defendants Shimer and Firth* recounted beginning on page 14 through 25 and then also pages 31 through 37 of this

Brief. Defendant Shimer's Motion for Summary Judgment is, therefore, appropriate with respect to Plaintiff CFTC's claim that Shimer violated Section 4b(a)(2) of the Commodity Exchange Act 7 U.S.C. § 6b(a)(2). Defendant Shimer's Motion For Summary Judgment with respect to Plaintiff's allegation that Shimer violated Section 4b(a)(2) of the Commodity Exchange Act 7 U.S.C. § 6b(a)(2) should be granted. For the same reason, Defendant Firth's Motion for Summary Judgment is, therefore, appropriate with respect to Plaintiff CFTC's claim that Firth violated Section 4b(a)(2) of the Commodity Exchange Act 7 U.S.C. § 6b(a)(2). Defendant Firth's separate Motion For Summary Judgment with respect to Plaintiff's allegation that Firth violated Section 4b(a)(2) of the Commodity Exchange Act 7 U.S.C. § 6b(a)(2) should be granted.

It is similarly appropriate that should defendant Equity's separate legal counsel file a separate Motion for Summary Judgment with respect to Plaintiff CFTC's allegation that Equity violated Section 4b(a)(2) of the Commodity Exchange Act 7 U.S.C. § 6b(a)(2) defendant Equity's separate Motion for Summary Judgment be granted.

IV. WITH RESPECT TO COUNTS I & II OF PLAINTIFF'S FIRST AMEMDED COMPLAINT

A. Good Faith is an Absolute Defense to Section 13(b) Liability

1. Plaintiff's allegation

As stated previously, the Division's primary basis for alleging deception and fraud against Shimer, Firth and Equity is the alleged misrepresentation of the returns that were achieved by Tech. The Commission seeks to hold Shimer, Firth and Equity liable under Section 13(b), 7 U.S.C. § 13c(b) derivative liability provisions for (a), "misrepresenting the performance of the commodity pool" (Amended Complaint, ¶57) and (b) "directly or indirectly ... employing a device, scheme, or artifice to defraud commodity pool participants, or ... engaging in transactions, practices or a course of business which operated as a fraud or deceit upon commodity pool participants by means of the acts and practices described above." (Amended Complaint, ¶ 74).

2. Facts and case law do not support a finding Shimer was a controlling person of Equity

Given the facts of the present case, the fact that the Division seeks to hold Shimer liable as a controlling person is a stretch of relevant precedent and is not supportable since the Commission clearly cannot meet its burden of showing bad faith or knowing inducement of the violative acts.[53] Moreover, while it is not disputed that Firth is a controlling person of defendant Equity, the Commission's assertion that Shimer, Equity's legal counsel, is a controlling person is unprecedented in the case law interpreting the Act. More importantly, it is respectfully submitted there is no *absolutely no evidence* that Shimer acted knowingly or in bad faith by concluding that Equity need not register as a commodity pool operator.[54] In fact the written record shows just the opposite— that (despite Shimer's arguably correct previous analysis of the CTA CPO issues with respect to his clients Shasta and Equity) both Shimer and Firth were at all times willing to cooperate fully with the CFTC and to register either Shasta or Equity if that was determined to be necessary and required.[55]

The Division's First Amended Complaint asserts that Shimer is a controlling person (as defined in Section 13(b) of the Act) of Equity Financial and as such is liable for Equity's violations of Sections 4b(a)(2); 4*o*(1); 4k(2); and 4m(1) of the Act, which prohibit fraudulent conduct and impose registration obligations for commodity pools and commodity trading advisors. Section 13(b) reads in its entirety as follows:

> "Any person who, directly or indirectly, controls any person who has violated any provision of this Act or any of the rules, regulations, or orders issued pursuant to this Act may be held liable for such violation in any action brought by the Commission to the same extent as such controlled person. <u>In such action, the Commission has the burden of proving that the controlling person did not act in good faith or knowingly induced, directly or indirectly, the act or acts</u>

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[53] See also previous discussion of the facts and relevant case law with respect to Section 4b(a)(2) liability beginning on page 30 of this Brief.

[54] (See later section of this Brief beginning on page 47 for extensive legal analysis that supports the conclusion that Shimer was not only acting in good faith but was arguably correct when, in the fall of 2001, he concluded that neither Shasta nor Equity met the definition of a CPO or CTA).

[55] Shimer's initial correspondence dated October 24, 2003 to Geoffrey Aronow at the prestigious Washington, D.C. law firm of Arnold & Porter and all e-mails back and forth between Firth, Shimer and either Aronow or Lee at Arnold & Porter (in the possession of the CFTC) *all support and do not contradict this contention*.

<u>constituting the violation</u>." 7 USC § 13c(b). (emphasis added)

For liability to be found under CEA § 13(b), there must be (a) an underlying violation, (b) control by the defendant, direct or indirect, over the person or entity that committed the underlying violation, and (c) either (i) an absence of good faith of the controlling person, or (ii) knowing inducement,, directly or indirectly, by the controlling person. *CFTC v. Standard Forex, Inc. et al.,* [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,063, *In re Spiegel,* [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,103 (CFTC 1988) Thus, the first step in establishing liability is to prove that the defendant was a controlling person.

In the instant case, the Commission is stretching established law by trying to categorize Shimer as a controlling person. Typically, persons on whom the Commission seeks to pin liability under § 13(b) of the CEA are officers, directors, or shareholders of the entity engaging in violative conduct, or employees thereof who are similarly engaged in supervisory roles. There is no CEA precedent for bringing an action against an outside attorney for section 13(b) liability. Moreover, under CEA Section 13(b) and the cases interpreting it, the controlling person must *actually control and influence the company*. Stated otherwise, defendants deemed to be controlling persons in other cases have exercised "near-complete authority over the firms." *CFTC v. Baragosh,* [2000 -2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,927; see also *CFTC v. Matrix Trading Group,* [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,191 (S.D. FL. 2004).

Firth is the sole owner and manager of Defendant Equity. Shimer had no authority to control that company. His role with respect to Shasta was primarily limited to drafting documents, arranging for the regulatory filings, and negotiating certain outside relationships. These are functions normally performed by outside attorneys for small companies. Portraying these functions as evidence of control has adverse policy implications for the attorney-client relationship and distorts Shimer's role in the circumstances of this case.

<u>B. Undisputed Facts Clearly Support A Finding Of Good Faith—Not The Case Law Requirement Of Bad Faith Or Knowing Inducement And Therefore Summary Judgment is Appropriate and Should be Granted</u>

But apart from the question of whether Shimer and Firth are controlling persons over Defendant Equity, the Commission faces the burden of proof of establishing that Shimer and

Firth acted in bad faith or knowingly induced the violative conduct. As stated by Judge Sifton of the Eastern District of New York in *CFTC v. Standard Forex, Inc.,* [1992-1994 Transfer Binder] Comm Fut. L. Rep. (CCH) ¶ 26,063, (E.D.N.Y. 1993), "[T]here must be either an absence of good faith on the part of the controlling person or some knowing inducement by the controlling person of the wrongful conduct, and this obviously is a requirement of culpability as opposed to a negligence or strict liability standard."

For a court to find knowing inducement it must find that "the controlling person had actual or constructive knowledge of the core activities that constitute the violation at issue and allowed them to continue." *CFTC v. Matrix Trading Group,* supra; *In re Spiegel,* [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,103 (CFTC 1988). And there is a substantial line of case law which holds that bad faith can be found only when a controlling person "did not maintain a reasonably adequate system of internal supervision and control over the [employee] or did not enforce with any reasonable diligence such system." *Monieson v. CFTC,* 996 F 2d. 852, 860 (7th Cir. 1993), [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,740; *In the Matter of Scott,* Comm. Fut. L. Rep. (CCH) ¶ 28,488 (CFTC 2003); *CFTC v. Matrix Trading Group, supra; In Re Dunhill Financial Group, Inc.* [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,711 (CFTC 1999).

The good faith of Shimer and Firth with respect to Shasta is evidenced not only by the legal advice previously rendered to both of his clients Shasta and Equity by Shimer but the further retention of Arnold & Porter (welcomed by Firth) when the registration issue was again raised in the Fall of 2003. Evidence of both Firth's and Shimer's good faith is further confirmed by Shimer's assertion to Arnold & Porter of the willingness of his clients to do whatever the CFTC might require with respect to registration. The good faith of both Shimer and Firth is further demonstrated by their genuine belief in the truthfulness of Murray.

That Shimer allowed his wife and brother and a member of his wife's family to invest in Shasta is strong evidence that Shimer never suspected that Tech's returns were not as represented by Murray and as conveyed to Equity each month by Teague. Nor should Shimer and Firth have known that these "return on investment" numbers were wrong.

Shimer's corporate client Edgar had loaned $150,000.00 for placement with Murray and had received back its initial investment, leaving in the Tech account designated for the receipt of Edgar's original funds significant remaining profits based upon performance numbers

consistently reported as of June, 2001 by Defendant Abernethy to Shasta's CPA. Shimer and Firth had no reason to doubt Abernethy's ability to perform the simple trading verification procedure required of Abernethy.[56] And as pointed out previously in this Memorandum while the alleged returns being reported by Tech to Shasta each month and separately verified by Abernethy were considerable, they were not above returns that other hedge funds or commodity pools achieve over limited periods of time.[57] As also previously pointed out, Tech Traders had at its disposal computer equipment capable of performing powerful mathematical computations and Murray appeared to have developed a sophisticated trading program and Shimer had every reason to believe that Murray was experiencing success with that trading program.

As for bad faith, the record clearly supports just the opposite conclusion. Shimer made efforts to put in place an independent verification procedure that would ensure the accuracy of the investment return figures. It is respectfully submitted that the correspondence previously cited between not only Shimer and Teague but also from Shimer to Murray with respect to the issue of reliable CPA verification of Tech's performance numbers clearly shows that Shimer was at all times acting in good faith in an attempt to ensure that each of his clients received reliable and accurate performance reporting from Tech. Moreover Abernethy testified during his deposition that Shimer continually bothered him to provide even more information to Shasta's CPA.[58]

Correspondence between Shimer and Teague, Shimer and Abernethy and also between Shimer and Murray shows that, if anything, Shimer wanted to *enhance* the verification process.[59]

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[56] See more extensive previous analysis and discussion in this Memorandum with respect to alleged Section 4b(a)(2) liability beginning on Page 30.

[57] See previous footnote 52, page 37.

[58] See, for example, Deposition of Vernon Abernethy dated June 8, 2004, page 130 and also page 154.

[59] See e-mail to Teague from Shimer dated February 22, 2002 sent at 11:02 PM in which Shimer states: "Vernon has agreed to provide you with additional verification that Tech has on account with its brokerage firms sufficient funds to cover the amount Shasta and New Century have on deposit with Tech."

See also Exhibit #43 to Deposition of Vernon Abernethy dated June 9, 2004. Exhibit #43 is an e-mail from Shimer to Vernon Abernethy dated March 15, 2002 sent at 3:20 PM which states in part: "This is the first month that Shasta has funds with Tech where results will be reported out to its shareholders. Part of that verification by Elaine to Shasta and its shareholders should also be that she has received separate verification that Tech's brokerage statements do reflect an amount still on deposit by Tech at the end of the month that is equal to Shasta's principal investment with Tech plus any accumulated profit allocated to Shasta under its investment agreement with Tech." Shimer's e-mail continues: "I would like to sort out and get that separate "amount still on deposit" verification process happening for February so that you and Elaine are comfortable with the established protocol for that additional verification."

And there is nothing in the record that demonstrates Shimer or Firth knew that Abernethy was not performing his responsibilities to ensure the accuracy of the return on investment percentages he continually forwarded to Teague. Thus, the record supports and limns a portrait of two individuals (Shimer and Firth) who took steps to verify that what they were being told (and what they had experienced) was accurate, who took steps to create and operate a verification process that would protect investors they solicited (and themselves and their families), and who acted in good faith in the belief that Tech was, in fact, securing the investment returns Murray claimed.

The worst that Shimer and Firth can be called is naïve. Naive for not suspecting that a CPA with Abernethy's credentials would ignore the specific procedures Abernethy consistently referred to in writing every month and would further ignore the clear requirement and understanding that he well knew was expected of him and clearly conveyed by Teague to Abernethy--*that he was supposed to be reviewing original unaltered brokerage statements as a critical and integral part of each monthly trading performance verification* he consistently forwarded to Teague.

The record shows that this additional verification process requested by Shimer still had not been implemented when Shimer received an e-mail from Teague dated September 5, 2002 asking: "What is the status on the letters I drafted that were sent to Vernon to ok? I just don't want to get caught without a vehicle to confirm balances when your clients start calling for verification."

The record further shows that Shimer sent a fax that basically amounted to an ultimatum on the balance verification issue to Murray dated September 10, 2002. In that fax to Murray Shimer stated "If Vernon decides (for whatever unknown reason) that he does not want to provide such a letter of confirmation to Elaine, then I think we really need to seriously talk about an alternate solution. One possibility might be to just let Elaine do what Vernon is doing now—only quarterly. … Another very simple possibility would be for Elaine to find another CPA in your area through her professional contacts that would be willing to come in monthly and just do what Vernon is doing now pursuant to these "Agreed upon procedures" and then also provide her with this simple additional letter."
The record further shows that Murray immediately replied to Shimer's fax in handwriting as follows: "No problem! Vernon will do!!! Bob, Vernon has agreed to do one quarterly as you and I agreed." The record shows that thereafter Vernon Abernethy finally began providing quarterly balance verification for Shasta's funds.

Moreover the record further shows that Shimer followed up the next day with another faxed dated September 11, 2002 to Murray basically reiterating Shimer's understanding that if a balance verification for a specific month was necessary for any individual month that did not fall at the end of a quarter, Vernon would provide a minimum balance verification for that particular month if so requested by Elaine. All of these communications by Shimer are in the possession of Plaintiff.

C. Just As Good Faith And Lack Of Scienter Precludes Section 4b(a)(2) Liability And Controlling Person Liability Under Section 13(b) For Alleged Violation Of Section 4(b)(a)(2), Lack Of Scienter And Good Faith On The Part Of the Equity Defendants Also Precludes Section 4*o*(1) Liability And Section 13(b) Liability For Alleged Violation Of Section 4*o*(1).

It is not necessary to again set forth the facts and repeat the case law analysis offered with respect to Plaintiff's allegation of 4b(a)(2) liability of the Equity Defendants. 7 U.S.C. § 6*o* (1), provides:

> (1) It shall be unlawful for a commodity trading advisor, associated person of a commodity trading advisor, commodity pool operator, or associated person of a commodity pool operator by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly —
>
> (A) to employ any device, scheme, or artifice to defraud any client or prospective client or participant; or
>
> (B) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant.

As Plaintiff correctly points out in its Brief on page 18, "the same conduct that violates Section 4b can violate Section 4*o*(1). (Citing *Stotler & Co. v CFTC*, 855 F.2d 1288, 1290-91 (7th Cir. 1988) and also *CFTC ex rel Kelly v Skorupskas*, 605 F. Supp. 923, 932 (E.D. Mich. 1985). Moreover Plaintiff clearly alleges Section 4*o*(1) liability with respect to the Equity Defendants by stating "The same misrepresentations by Defendants to pool participants that violate Sections 4b of the Act, as set forth above, also violate Section 4o(1)"[60]

By reason of the undisputed facts set forth previously in this Brief and the overwhelming evidence of the good faith of defendants Shimer and Firth with respect to the alleged violation of Section 4b(a)(2) of the Commodity Exchange Act and by further reason of the necessary element of *scienter* clearly required by the case law cited with respect to the issue of alleged Section 4b(a)(2) liability, Summary Judgment is appropriate in favor of all of the Equity Defendants with respect to their alleged direct violation of Section 4*o*(1) of the Act. For that reason defendant Shimer's Motion For Summary Judgment should be granted with respect to Plaintiff's allegation in Count II of its First Amended Complaint that Shimer violated Section 4*o*(1) of the Commodity

[60] See Brief In Support of Plaintiff's Motion For *Ex Parte* Statutory Restraining Order And Preliminary Injunction, page 19.

Exchange Act 7 U.S.C. § 6o(1). Similarly, for that reason defendant Firth's Motion For Summary Judgment should be granted with respect to Plaintiff's allegation in Count II of its First Amended Complaint that Firth violated Section 4*o*(1) of the Commodity Exchange Act 7 U.S.C. § 6o(1).

Furthermore, should defendant Equity's legal counsel decide to later file a Motion For Summary Judgment with respect to Plaintiff's allegation that defendant Equity violated Section 4*o*(1) of the Commodity Exchange Act, 7 U.S.C. § 6o(1), defendant Equity's separate Motion for Summary Judgment should be granted.

In light of the overwhelming evidence of Shimer's good faith and lack of scienter on the part of defendant Shimer (as well as a lack of any evidence that Shimer acted as a controlling person of Equity) Shimer's motion for Summary Judgment is appropriate and should be granted with respect to Plaintiff CFTC's claim that Shimer is a controlling person (as defined in Section 13(b) of the Act) of Equity Financial and did not act in good faith and knowingly induced Equity's violation of Section 4b(a)(2) of the Commodity Exchange Act 7 in violation of Section 13(b) of that Act 7 U.S.C. § 13c(b).

By reason of all of the facts previously stated in this Brief which constitute overwhelming evidence of good faith on the part of Shimer and, in light of a total lack of any substantial evidence supporting the required element of scienter on the part of Shimer, Summary Judgment is further appropriate and should be granted to defendant Shimer with respect to Plaintiff CFTC's allegation in Count II of Plaintiff's First Amended Complaint that Shimer violated Section 4*o*(1) of the Commodity Exchange Act, 7 U.S.C. § 6*o*(1) either directly or as a controlling person of Equity in violation of Section 13b of the Act.

In light of the overwhelming evidence of Firth's good faith and lack of scienter on the part of defendant Firth in his capacity as a controlling person of Equity Firth's motion for Summary Judgment is appropriate and should be granted with respect to Plaintiff CFTC's allegation that Firth, as a controlling person of Equity did not act in good faith and knowingly induced Equity's violation of Section 4b(a)(2) of the Commodity Exchange Act 7 in violation of Section 13(b) of that Act 7 U.S.C. § 13c(b).

By reason of all of the facts previously stated in this Brief which constitute overwhelming evidence of good faith on the part of Firth and, in light of a total lack of any substantial evidence supporting the required element of scienter on the part of Firth, Summary Judgment is further

appropriate and should be granted to defendant Firth with respect to Plaintiff CFTC's allegation in Count II of Plaintiff's First Amended Complaint that Firth violated Section 4*o*(1) of the Commodity Exchange Act, 7 U.S.C. § 6*o*(1) either directly or as a controlling person of Equity in violation of Section 13b of the Act.

Furthermore, in light of the overwhelming evidence of the good faith and lack of scienter on the part of all of the Equity Defendants, should Equity's separate legal counsel later file a Motion of Summary Judgment with respect to Plaintiff CFTC's allegation in Count II of Plaintiff's First Amended Complaint that defendant Equity directly violated Section 4*o*(1) of the Commodity Exchange Act 7 U.S.C. § 6*o*(1) and that defendant Equity also violated Section 2(a)(1)(B) of the Commodity Exchange Act, 7 U.S.C. § 2a(1)(B) by reason of the unsubstantiated alleged violation of Section *4o*(1) of the Act by defendants Shimer and Firth, Summary Judgment is also appropriate for defendant Equity and should be granted.

V. WITH RESPECT TO COUNTS I THROUGH IV OF PLAINTIFF'S FIRST AMENDED COMPLAINT THE FACT THAT CASE LAW AND THE CFTC'S OWN REGULATIONS DO NOT SUPPORT A FINDING THAT SHASTA IS A COMMODITY POOL IS AN ABSOLUTE BAR TO A FINDING OF FRAUD AS ALLEGED UNDER SECTION 4b(a)(2) & SECTION 4*o*(1) OF THE COMMODITY EXCHANGE ACT WITH RESPECT TO SHIMER, FIRTH AND EQUITY; A SIMILAR BAR TO ALL SECTION 13(b) LIABILITY WITH RESPECT TO SHIMER AND FIRTH; A BAR TO SECTION 4m(1) AND SECTION 2(a)(1)(B) LIABILITY WITH RESPECT TO EQUITY; A BAR TO SECTION 13(a) LIABILITY WITH RESPECT TO SHIMER; AND A BAR TO SECTION 4K(2) LIABILITY AS ALLEGED WITH RESPECT TO SHIMER, FIRTH AND EQUITY.

A. No Case Law Authority Cited In Plaintiff's Brief For *Ex Parte* Statutory Restraining Order And Preliminary Injunction Supports The Often Repeated Conclusion In Plaintiff's First Amended Complaint That Shasta Is A "Commodity Pool".

Not a single case cited by the Division in its Brief In Support Of Plaintiff's Motion For *Ex Parte* Statutory Restraining Order and Preliminary Injunction (hereinafter "Brief") supports the Division's contention in its Original or First Amended Complaint that Shasta is a "commodity pool". If Shasta is not a commodity pool Equity cannot be held to be the "operator" of a commodity pool. The entire action brought against the Equity Defendants for violation of the Commodity Exchange Act (including the *Ex Parte* Restraining Order initially sought by the Division) is arguably the result of a smoke and mirrors sleight of hand perpetrated deliberately by the Division to the severe detriment of the Equity Defendants.

Again and again throughout the Division's Original Complaint filed on April 1, 2004 one finds constant references to Shasta as a "pool" or "commodity pool" as if constant repetition will somehow make it so.[61] Clearly the Division's entire basis for filing its Original Complaint and seeking an *Ex Parte* Restraining Order against Shimer, Firth and Equity and then filing a First Amended Complaint against all of the Equity Defendants is grounded on the absolute legal necessity that, as alleged by Plaintiff, Shasta is a "commodity pool". Shimer and Firth offer both controlling case law and the CFTC's own regulations in support of the proposition that, as a matter of law, Shasta is *not* a "commodity pool".

B. Case Law Cited By Plaintiff Supports The Conclusion That Shasta Is *Not* A Commodity Pool.

1. *Lopez v Dean Witter Reynolds, Inc.*

On page 2 of its Brief the Division initially refers to Shasta as "a commodity pool" and cites as its authority the Ninth Circuit case of *Lopez v. Dean Witter Reynolds, Inc*., 805 F.2d 880 (9th Cir. 1986). Shimer and Firth agree with the Division that *Lopez* is instructive. But the test laid down in Lopez for determining whether an entity meets the specific definition of a "commodity pool" does not favor the Division's conclusion with respect to Shasta.

Lopez involved several claims by various clients of Dean Witter Reynolds ("Dean Witter") who had suffered losses in investments they had made through Dean Witter. One particular plaintiff (Reitzell) alleged that Dean Witter had violated the Commodity Exchange Act because her account in which losses occurred was an account in which commodities futures contracts were purchased and sold, and therefore, constituted a "commodity pool". The *Lopez* case cited by the Division was an appeal to the Ninth Circuit Court of Appeals by Lopez and Reitzell and other clients of Dean Witter from a dismissal by the lower court of the CEA claim.

Reitzell, individually, charged Dean Witter with violating the CEA by inducing her to invest in its Commodity Guided Account Program ("CGAP"). In addition, Reitzell brought a class action against Dean Witter, on behalf of all other persons investing in the CGAP account. The *Lopez* court in a footnote offered the following description of the Dean Witter CGAP account and, because the actual "commodity trading activity" of that particular account is

[61] The Division's original complaint filed on April 1, 2004 referred to Shasta as a "pool" no less than 20 times.

instructive, we quote the *Lopez* court's footnote verbatim:

> "The CGAP in which Reitzell invested, which is the subject of this appeal, was a program in which eighty percent of a customer's deposit was placed in U.S. Treasury bills to accrue interest, with the remaining twenty percent placed in an account, along with funds from other participants in the CGAP. It was from these combined funds that commodities futures contracts were purchased and sold. However, each investor had separate accounts to which individual account numbers were assigned, and an individual's ability to engage in any purchases or trades of a particular commodity was dependent upon the minimum equity level in that individual's account. Thus, not all accounts traded the same contracts, and when a decision to trade or purchase was made, it was necessary for Dean Witter to determine which accounts were eligible to buy or sell a particular commodity and how many contracts per account would be traded. Once traded, a transaction would be assigned to the appropriate, participating individual customer's account." (See *Lopez,* footnote 2.)

The *Lopez* Court stated:

> "in order to determine whether the commodity accounts which Appellants held with Dean Witter were subject to the provisions of the statute, our first inquiry must be whether Dean Witter was running a commodity pool subject to the requirements of the Commodity Exchange Act, 7 U.S.C. Sec. 1, et seq. (1982). A commodity pool operator ("CPO"), defined at 7 U.S.C. Sec. 2, is one who is engaged in a business 'of the nature of investment trust, syndicate, or similar form of enterprise.' The Commodity Futures Trading Commission ("CFTC") regulations track the statute. However, no authority binding on us has spelled out the definition more precisely. Consequently, we are faced with an undecided question." (*Lopez* at 883)

The *Lopez* court noted that "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." (*Lopez* at 883). The court then noted that "Dean Witter argues that in order to constitute a commodity pool, there must be a pro rata sharing by the participants of profits and losses, and since here, there was no such sharing, there was no pool. Appellants on the other hand, argue that at the crucial moment when a trade was executed, it was executed for the combined account, not for any individual customer. Thereafter, the contracts were allocated to individual accounts, and this allocation of contracts performed a function similar, although not identical, to a pro rata division of the profits and losses." (*Lopez* at 884).

2. **The *Lopez* Four Part Test**

The *Lopez* court then observed that “those courts which have raised the issue *require the following factors to be present in a commodity pool*: (1) an investment organization in which the funds of various investors are solicited and combined into a single account *for the purpose of investing in commodity futures contracts*; (2) common funds used to *execute transactions on behalf of the entire account*; (3) participants share pro rata in accrued profits or losses from the commodity futures trading; and (4) the transactions *are traded by a commodity pool operator in the name of the pool* rather than in the name of any individual investor. (Emphasis added). *Commodities Futures Trading Commission v. Heritage Capital Advisory Services, Ltd.*, Comm.Fut.L.Rep. (CCH) p 21,627, p. 26,384 (N.D.Ill.1982); *Meredith v. ContiCommodity Services, Inc.*, Comm.Fut.L.Rep. (CCH) p 21,107, p. 24,462 (D.D.C.1980).” *Lopez* at 884.

The *Lopez* Court then concluded:

> “Applying the above requirements to Dean Witter's CGAP, we find that the program *did not have the necessary characteristics to constitute a pool*. There was a disparity in investment in the individual accounts, and because of the equity level required to engage in certain purchases and trades, not all accounts traded the same contracts. Therefore, not all accounts shared a pro rata profit or loss. (Emphasis added)
>
> Although the CGAP possessed *some of the requirements* which have been deemed necessary to constitute a commodity pool, reviewing "all the facts relevant to the entity's operation," *the CGAP's characteristics are sufficient to distinguish it from a commodity pool*. (Emphasis added). See 46 Fed.Reg. 26004, 26005-6 [1980-1982 Transfer Binder] Comm.Fut.L.Rep. (CCH) p 21,188, p. 24,891 (May 8, 1981). Furthermore, while we recognize that the speculative commodities market requires strict regulation, we do not find the CGAP to be the type of account which Congress intended to constitute a commodity pool subject to the registration, reporting requirements of the Commodity Futures Exchange Act.” *Lopez* at 884.

So, to be very clear… the Division cites in its Brief the authority of *Lopez* for the proposition that Shasta is a “commodity pool”. But the *Lopez* court *refused to conclude* that Dean Witter’s CGAP account was a commodity pool (based upon a finding by the Court that no pro rata sharing occurred) *despite the fact* that the CGAP account at Dean Witter was an account

in which *commodity contract trades were placed on behalf of clients* (trades that obviously occurred on a contract market) *pursuant to trading authority specifically conferred upon Dean Witter by those clients!*

3. Applying The *Lopez* Four Part Test, Shasta Is Not A Commodity Pool.

Taking *Lopez* at its word, it is necessary to review "all the facts relevant to the entity's operation" before a finding can be made that a particular entity qualifies as a “commodity pool”. Unlike the Dean Witter CGAP account in *Lopez*, where are the “commodity contracts” being “traded” by either Shasta or by Shasta’s manager Equity? Neither entity has a brokerage account at any FCM. Neither entity has ever conducted *any trade* for *any client!* A reality check requires that an analysis of the four part test laid down in *Lopez* be applied to the facts of Shasta and defendant Equity.

a. Shasta fails to pass the first “test” of Lopez

The necessary first part of the four part *Lopez* test for determining whether or not an entity is a commodity pool is (1) an investment organization in which the funds of various investors are solicited and combined *into a single account for the purpose of investing in commodity futures contracts*. Where is the “single account” into which Shasta member funds were combined for the “purpose of investing in commodity futures contracts”?

The Division apparently refers in its Complaint to the fact that Shasta member funds were first “pooled” in Shimer’s attorney escrow account at Citibank before they were transmitted to the bank account of defendant Tech but clearly there was no “commodity futures contract” trading being conducted from Shimer’s attorney escrow account. Nor did Shasta ever own any account that traded commodity futures contracts and neither did defendant Equity. Nor was there ever *any representation by Shasta or by defendant Equity at any time to anyone in any of Shasta’s subscription documents nor on its web site* that Shasta owned or controlled any such an account that “invested (or ever intended to invest) in commodity futures contracts”. Never did either Shasta or its manager defendant Equity *ever trade futures contracts for or on behalf* of some mythical “account”.

Shasta's members were not "investing in commodity futures contracts". Shasta's members simply purchased LLC membership interests in a company (Shasta) that had a investment contract with another separate entity (defendant Tech) that had *its own* trading account *in its own name*. Defendant Tech traded futures contracts from a brokerage account(s) registered solely in its own name for and on its own behalf—and *that fact was clearly disclosed to every prospective member of Shasta.*

The CGAP account at Dean Witter clearly met this first part of the *Lopez* test so a discussion of that first criteria was obviously unnecessary by the *Lopez* court. Shasta, clearly, *does not* meet that test. Just as *Lopez* held that the Dean Witter CGAP account was not a commodity pool because it failed the third test (the "pro rata test"), if we are to consider *Lopez* controlling (as the Division seems to insist in its Brief), Shasta similarly does not qualify as a "commodity pool" by reason of the fact that Shasta fails the first test enunciated by *Lopez*.

b. <u>Shasta fails to pass the second test of *Lopez*.</u>

The necessary second part of the Lopez test for determining whether or not an entity is a commodity pool is: (2) common funds used to execute transactions on behalf of the entire account. As pointed out during the above analysis of the first part of the *Lopez* test, there is no "account" owned or controlled by either Shasta or by Equity from which any commodity futures related "transactions" could be "executed". Since this second part of the *Lopez* test clearly requires that *transactions be executed* by the entity that is controlling or operating the pool "account" it is impossible for Shasta to qualify under this second part of the *Lopez* test.

Dean Witter clearly met this second part of the *Lopez* test. It is clear from the *Lopez* court's description of the CGAP account that commodity futures contracts on behalf of all CGAP clients were regularly executed by Dean Witter for an on behalf of the CGAP account.. And yet *despite that clear fact* the Dean Witter account was held by *Lopez* to *not* be a commodity pool.

c. <u>Shasta arguably fails to pass the third test of Lopez</u>.

The necessary third part of the Lopez test for determining whether or not an entity is a commodity pool is: 3) participants share pro rata in accrued profits or losses from the commodity futures trading. Shasta's members did not share "pro rata with other participants in the pool"

traded by Tech (the only "pool" that was ever traded by anyone) because there clearly were a number of other entities that invested with Tech under similar but slightly different profit sharing arrangements with Tech.

Exhibits 55 and 65 of the deposition taken by Vernon Abernethy contain the terms of certain agreements executed by various other individuals and entities (some still unknown to Shimer) as well as at least one Sterling controlled entity (The Strategic Investment Portfolio) that apparently enjoyed different profit sharing formulas with Tech than enjoyed by Shasta for funds placed into Tech's "super fund account for trading. Just as the CGAP account at Dean Witter, Shasta arguably, therefore, fails the third part of the *Lopez* test.

d. Shasta *clearly* fails to pass the fourth test of Lopez.

The necessary fourth part of the *Lopez* test for determining whether or not an entity is a commodity pool is: 4) the transactions are traded *by a commodity pool operator in the name of the pool* rather than in the name of any individual investor. This last test has to qualify as probably the Division's *least favorite* of all of the four tests imposed by the *Lopez* court in determining whether or not a particular entity meets the definition of a commodity pool! This fourth part is, however, the most instructive because it sets out in plain language a test that clearly was meant to apply to those entities intended by Congress to be commodity pools for purposes of the CEA (as interpreted by the Division's primary cited authority which is *Lopez*). But even more importantly, the court in *Lopez* imposes a test that is in complete harmony with that section of the CFTC's own regulations that specifically defines the term commodity pool or "pool"[62]

The fourth part of the *Lopez* test is clear for anyone who can read the English language. This fourth part was obviously intended by the *Lopez* court to be as critical and necessary a part of the overall test as any other of the four parts. The court in *Lopez* did not "weight" the various parts of its test. Each of the four parts of the *Lopez* test are *all equally critical for a finding that a*

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[62] See 17 C.F.R. § 4.10(d)(1). Though the cited Regulation itself only purports to define the term "pool" the CFTC specifically refers to this particular regulatory cite in its First Amended Complaint for the definition of the term "commodity pool". See Plaintiff's First Amended Complaint, page 8, ¶ 11.

commodity pool exists for purposes of the CEA. The "transactions" of the pool (meaning the trading of commodity futures interests) must be effected by the pool's operator! Just when did the purported "operator" of the Shasta pool (defendant Equity) ever trade any commodity interest for the benefit of anyone?

It was not hard for the *Lopez* court to find an "operator" effecting commodity interest transactions for the Dean Witter CGAP account. This last test was never discussed by the *Lopez* court at all because *it was very clear and obvious that Dean Witter was transacting commodity interest trades for the benefit of its CGAP account clients.* In other words, Dean Witter was clearly performing as an "operator" of the CGAP account, (an account from which commodity interest transactions were obviously being effected by Dean Witter for the clear benefit of Dean Witter's clients). And yet it is instructive to note that *in spite of this fact (apparently so clear and obvious to the Lopez court that it did not even merit any discussion at all)*, the *Lopez* court *refused to hold that the CGAP account at Dean Witter was a commodity pool*, *thereby relieving Dean Witter of any liability under the CEA!* The "lesson" of *Lopez* is: in the absence of any basis for finding that "entity A" (for example, Shasta) meets the definition of a "commodity pool" it is virtually impossible to conclude that an affiliated "entity B" (for example, defendant Equity) is a commodity pool "operator".

4. *Lopez* has been favorably cited by the Third Circuit Court of Appeals

Moreover a review of additional case law reveals that *Lopez* is apparently considered significant and relevant by the Third Circuit Court of Appeals with respect to the issue of whether or not an entity qualifies as a commodity pool under the CEA. Defendants Shimer and Firth respectfully refer the Court to *Nicholas v. Saul Stone & Co* 224 F.3d 179 (3rd Cir. 2000). In Nicholas the plaintiffs alleged that certain individuals had held themselves out as successful managers of various commodity pools and were thus able to raise between forty-one and sixty-eight million dollars. The plaintiff investors were told that the funds would be placed in a commodities trading pool and used to invest in commodities futures and options.

The Plaintiffs and other investors signed powers of attorney giving discretionary authority over investing and trading decisions with respect to their investments. The Plaintiffs in *Nicholas* further alleged that, although these individuals did, in fact, invest the solicited funds through a variety of futures commodities merchants ("FCMs"), the bulk of those investments

failed. In the initial phases of the allegedly fraudulent scheme, investors seeking to withdraw their funds or profits were paid with the funds of later investors, thus creating the aura of success.

There was never any question in *Nicholas* that the individuals who made the false representations were, indeed, acting as commodity pool operators. It is instructive, however, that 14 years after the decision in *Lopez* the court in *Nicholas* apparently deemed *Lopez* to be a sufficiently accurate and instructive authority with respect to the definition of the term "commodity pool" to refer favorably to the four part test developed by *Lopez* in a footnote as follows:

> "The Ninth Circuit, speaking through Judge Nelson, has pointed out that "[w]hile numerous courts have dealt with the concept of commodity pools in the abstract, few have specifically attempted to define what constitutes a pool." *Lopez v. Dean Witter Reynolds, Inc*., 805 F.2d 880, 883 (9th Cir. 1986). Using as its models the few relatively precise judicial descriptions of the operations of commodities pools, the Ninth Circuit drew the following profile of a pool: "(1) an investment organization in which the funds of various investors are solicited and combined into a single account for the purpose of investing in commodity futures contracts; (2) common funds used to execute transactions on behalf of the entire account; (3) participants share pro rata in accrued profits or losses from the commodity futures trading; and (4) the transactions are traded by a commodity pool operator in the name of the pool rather than in the name of any individual investor." Id.
> *Nicholas* at page 190 (footnote 4)

5. Plaintiff's reliance on *Lopez* apparently received little close analysis by previous legal counsel for Shimer and Firth.

Apparently the Division pursued its Section 4b(a)(2), Section 13b and Section 4*o*(1) allegations of fraud against defendants Shimer, Firth and Equity with the expectation and hope that no one would ever examine the cite in its Brief to *Lopez* too closely. The implications of the *Lopez* test are equally fatal for a finding of liability by Shimer and Firth under all other Sections of the Commodity Exchange Act as alleged by Plaintiff in Counts I-IV of Plaintiff's First Amended Complaint. Apart from the obvious ethics issues attendant to such a tactic on the part of the Division, it is disappointing to both Shimer and Firth that previous legal counsel Menaker & Herrmann (previously retained in this matter on behalf of Shimer and Firth *for almost a full year*) never discussed or pointed out to either Shimer or Firth the apparent contradiction between *Lopez* and the Plaintiff's repeated allegation that Shasta is a "commodity pool". In the absence of

a finding that Shasta meets the definition of a "commodity pool", Plaintiff's constantly repeated allegation throughout its First Amended Complaint that defendant Equity is a commodity pool "operator" cannot be sustained and therefore, all alleged violations of the CEA that flow from Equity's alleged status as a Commodity Pool Operator similarly cannot be sustained.

The fact that it has become necessary for Shimer, representing himself *pro se* to set forth the facts of this matter, to research the case law cited by Plaintiff in its Brief, to review the critical decision of *Lopez* and apply the analysis of *Lopez* to Shasta and to finally file this Brief *pro se* in support of the separate Motions of Shimer and Firth is a source of understandable frustration for both Shimer and Firth. For Plaintiff CFTC to propose a "new definition" of the term "commodity pool" specifically designed to "fit" the facts of defendant Equity the CFTC will be forced to argue against the currently controlling four part analysis of *Lopez*--the very case cited on page 2 of Plaintiff's Brief for the ill considered proposition that Shasta *is* a "commodity pool".

C. <u>Other Case Law Cited In Plaintiff's Brief Does Not Qualify, Overrule Or Contradict *Lopez* In Any Way</u>.

It is interesting to note that Plaintiff arguably compromises its constant contention that Shasta is a "commodity pool" by admitting in its Brief that:

> "one acts as a CPO by, among other things, soliciting and accepting funds from multiple investors, pooling those funds together *to place trades in the commodity futures markets* and managing the pool. [63]

This is apparently a shallow attempt on the part of Plaintiff to give cursory lip service to the first test enunciated in *Lopez* while studiously ignoring all other parts of the test (including the critical fourth test) which clearly requires that for a "commodity pool" to exist, commodity futures contract transactions must "*be traded by a commodity pool operator in the name of the pool* rather than in the name of any individual investor". *Lopez* at page 884.

The CFTC would prefer this Court to overlook the fact that the alleged "operator" of the alleged Shasta "pool" (defendant Equity) never traded commodity futures contracts for anyone-not in its own name, not in Shasta's name (the alleged "pool") nor in any individual investor's

[63] Brief in Support of Plaintiff's Motion for *Ex Parte* Statutory Restraining Order and Preliminary Injunction, p. 19.

name. It is particularly instructive to note that none of the cases specifically cited on page 19 of its Brief support the Plaintiff's anemic "CPO argument" with respect to Equity.

1. *Slusser v. CFTC*

The CFTC first cites *Slusser v. CFTC*, 210 F.3d 783 (7th Cir.2000) in support for the position that Equity is a Commodity Pool Operator. *Slusser* is clearly not helpful to the CFTC and *does not* support the CFTC in its claim that Equity (an entity that has never traded commodity futures contracts for the account of *anyone*) is or ever was a CPO.

The 7th Circuit's opinion in *Slusser* noted that Jerry Slusser and entities he controlled came into possession of approximately $29 million that German investors had entrusted to International Participation Corporation (IPC) for investment in American financial markets. IPC raised the money using a prospectus offering investors a choice from a number of portfolios. Portfolios III and IV were to be invested in financial futures traded on a public exchange. There was never any doubt that Slusser or entities that he controlled were trading for and on behalf of the IPC commodity pools. As noted by the 7th Circuit, the two commodity pools traded by Slusser that collectively contained

> "approximately $29 million in May 1989 dwindled to $16 million by November, when Slusser *ceased the churning* and wired the remaining funds to Germany." (Emphasis added). *Slusser* at 784.

The 7th Circuit in *Slusser* understandably and correctly upheld the CFTC's finding

> "that Slusser had violated the Commodity Exchange Act, 7 U.S.C. sec. 1-25," in part because " he failed to register with the CFTC as a "commodity pool operator" and its "associated person" even though he was managing a commodity pool--initially on behalf of IPC, then after the end of May 1989 in his own right, following a contractual assumption of IPC's position." *Slusser* at page 784.

Based upon the clear fact that Slusser or entities that he controlled *engaged directly in trading on behalf of these IPC commodity pools*, in response to one of Slusser's arguments (that he did not know the source of the funds he was trading) the 7th Circuit had the following comment:

> "Then what was he doing *trading at a riotous pace*, rather than purchasing safe vehicles such as Treasury bills until the money's owner could be determined? Slusser made the most of an opportunity to charge big commissions without supervision. The CFTC as regulator of pool operators is entitled to require more conscientious management of unknown investors' money." (Emphasis added). *Slusser* at 785.

2. *SEC v Princeton Economic Int'l*

The CFTC also cites the case of *SEC v Princeton Economic Int'l* , 73 F.Supp.2d 420,424 (S.D.N.Y.) 1999) (hereafter "*SEC v Princeton*") as further support for its proposition that defendant Equity is a CPO.[64] This was a case involving both the SEC and the CFTC. According to the court in *SEC v Princeton* the CFTC sought "a statutory restraining order pursuant to section 6c of the Commodity Exchange Act, 7 U.S.C. § 13a-1, freezing defendants' assets, prohibiting the destruction of, and giving the CFTC access to, defendants' books and records, and continuing the receivership." (*SEC v Princeton* at 423) The CFTC alleged that Armstrong and the corporate defendants engaged in fraud in violation of sections 4b(a)(i)-(iii) and 4*o*(1) of the Commodity Exchange Act and failed to register with the CFTC as Commodity Pool Operators ("CPOs") and Commodity Trading Advisors ("CTAs") in violation of section 4m.

The court in *SEC v Princeton* stated:

> "as to the claim that defendants have violated section 4m of the Act, by failing to register as CPOs or CTAs, the CFTC presented evidence that defendants, since at least November 1997, have commingled the proceeds derived from the sale of notes to customers in a commodity pool, and that defendants and/or their agents issued trading advice and direction *and maintained authority and discretion over the funds*. These are functions of a CPO". (Emphasis added). *SEC v. Princeton* at 424.

The court in *SEC v. Princeton* also noted that, "the CFTC has put before me evidence that defendants have acted as CTAs and CPOs, despite their failure to register with the CFTC" and further noted, "defendants make no presentation putting in issue the CFTC's showing". (at page 424). The court in *SEC v Princeton* engaged in no analysis of the CPO issue other than to cite the definition of a CPO found at 7 U.S.C. § 1a(5). This same statutory definition was also cited

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[64] Brief in Support of Plaintiff's Motion for *Ex Parte* Statutory Restraining Order and Preliminary Injunction, p. 19.

by *Lopez* before *Lopez* engaged in its extensive analysis which resulted in the *Lopez* four part test. The *Lopez* decision is significant because as the *Lopez* court noted:

> "While numerous courts have dealt with the concept of commodity commodity pools in the abstract, few have specifically attempted to define what constitutes a pool." *Lopez* at p. 883.

It is important to remember that merely reciting the statutory definition of a CPO found at 7 U.S.C. § 1a(5) (as the court did in *SEC v. Princeton*) is no substitute for a careful factual analysis to determine whether or not a commodity pool exists. As *Lopez* noted before constructing its four part test for determining whether a "commodity pool" exists under any given set of facts:

> "The Commodity Exchange Act fails to provide any assistance in this regard." *Lopez* at 883.

The *Lopez* decision represents significant and thoughtful authority with respect to the "CPO issue" and nothing cited by the CFTC in its Brief contradicts *Lopez* or qualifies the necessary four part test of *Lopez* in any way.

D. The CFTC'S Own Regulations Do Not Support Plaintiff's Claim That Shasta Is A Commodity Pool

The Plaintiff's Original Complaint and its Brief filed with the Court in support of that Complaint and Plaintiff's *Ex Parte* Motion For Statutory Restraining Order against the Equity Defendants assert a critically erroneous assumption that cannot be sustained by Plaintiff's own regulations. Plaintiff's Original Complaint as well as its First Amended Complaint alleges incorrectly that Shasta is a commodity pool. Only by purposefully mischaracterizing Shasta as a "pool" subject to the CFTC's own regulations can Plaintiff allege that Defendant Equity is the unregistered "operator" of the Shasta "pool". The Plaintiff's Original and First Amended Complaint is a house of cards built upon sand.

1. Shasta does not meet the definition of a "pool" as defined by 17 C.F.R. § 4.10 (d)(1)

For defendant Equity to be classified as a Commodity Pool Operator, the entity that it manages must meet the definition of a commodity pool ("pool") as that term is specifically

defined by the CFTC's own regulations. But Shasta is not a commodity pool or "pool" as that term is specifically defined by the Commission's regulations found at 17 C.F.R. § 4.10 (d)(1):

> "*Pool* means any investment trust, syndicate or similar form of enterprise operated *for the purpose of trading commodity interests*," (Emphasis added)

The definition of "Commodity interest" is found at 14 C.F.R. § 4.10 (a). The term "commodity interest" is specifically defined there as follows:

> "Commodity interest means:
> (1) Any *contract for the purchase or sale of a commodity for future delivery*; and
> (2) Any contract, agreement or transaction subject to Commission regulation under section 4c or 19 of the Act. (Emphasis added)

Neither Shasta nor its manager Equity has ever "traded" a contract for "the purchase or sale of a commodity for future delivery" nor have they ever been *operated* for the purpose of *trading* "commodity interests". Neither entity has ever maintained or ever opened an account at any Futures Commission Merchant for the trading of any "contract for the purchase or sale of a commodity for future delivery".

2. It would be impossible for Shasta or for its manager Equity to comply with the CPO Account Statement requirements of 17 C.F.R. § 4.22(a).

Moreover the CFTC's own regulations for reporting to "pool" participants found at 17 C.F.R. § 4.22 are consistent with this conclusion because 17 C.F.R. § 4.22 makes it *virtually impossible* for an entity such as Shasta and, therefore, for any entity such as Shasta's manager Equity that has never opened a trading account at an FCM to ever comply with the Account Statement requirements specifically enumerated at 17 C.F.R. § 4.22 (a). That section of the CFTC's regulations specifically requires that Account Statements [in the form of a Statement of Income (Loss)] be issued to pool participants on a regular basis and that those Statements of Income or (Loss) "must separately itemize the following information:

> (i) The total amount of realized net gain or loss on commodity interest positions liquidated during the reporting period;
> (ii) The change in unrealized net gain or loss on commodity interest positions liquidated during the reporting period;
> (iii) The total amount of net gain or loss from all other transactions in which the pool engaged during the reporting period, including interest and dividends earned on funds not paid as premiums; …
> (vi) The total amount *of all brokerage commissions during the reporting perio*d;

(vii) The total amount *of other fees for commodity interest and other investment transactions* during the reporting period; (Emphasis added)

All of this information required to be reported to pool participants is *only available* to an entity that *actually maintains an account in its name that trades "commodity interests"*. How can an entity that has never opened a commodity trading account at an FCM report "the total amount of all brokerage commissions"?

Even assuming, arguendo, that Equity had complied with all initial registration requirements of the Plaintiff, it would be virtually impossible for Equity to ever comply with the regulations found at 17 C.F.R. § 4.22 (a) imposed by the CFTC upon Commodity Pool Operators because Shasta's manager Equity has never had access to the sort of information that "pool operators" are required to report because Shasta is not and has never been a "pool" "operated for the purpose of trading commodity interests".

Every entity subject to an similar enforcement action by Plaintiff for failure to register as a commodity pool operator has had ready access to the type of information required to be reported by 17 C.F.R. § 4.22 (a). Defendant Shimer challenges Plaintiff to provide to the Court even one instance in which an entity such as defendant Equity that has never opened a commodity trading account at an FCM (and that has never represented *to anyone* that it did open or intended to open such an account for commodity futures trading) was held by either the Commission or by any court to be a Commodity Pool Operator.

3. CPO record keeping requirements of 17 C.F.R. § 4.23 require direct access to FCM account information never available to Shasta or its manager Equity

Moreover, the record keeping requirements imposed upon commodity pool operators by 17 C.F.R. § 4.23 only further support the fact that Shasta is not a commodity pool. Clearly the record keeping requirement of 17 C.F.R. § 4.23 (a) (1) not only presupposes but seems to require ownership of an account at an FCM from which commodity interests are traded:

"(a) *Concerning the commodity pool*:

(1) An itemized daily record of each commodity interest transaction of the pool, showing the transaction date, quantity, commodity interest, and, as applicable, price or premium, delivery month or expiration date, whether a put or a call, strike price, underlying contract for future delivery or underlying physical, the futures commission merchant carrying the account and the introducing broker, if any,

> whether the commodity interest was purchased, sold, exercised, or expired, and the gain or loss realized.

Defendant Equity as the purported "operator" never had access to the types of information specifically mentioned above in 14 C.F.R. § 4.23 (a) (1) because that sort of information would only be available to the "operator" of a "commodity pool"—ie an entity "operator" that has direct access and control over an account where futures are traded in the name of the pool either by reason of the fact that the "operator" entity itself is doing the trading on behalf of the "pool" or by reason of the fact that the trading account (being registered in the name of the "pool") thus allows the Operator access to all trading activities that occur in the "pool's" trading account.

Furthermore, the specific recording keeping requirement imposed upon commodity pool operators by 17 C.F.R. § 4.23 (a) (7) makes it equally obvious that to be considered to be the "operator" of a pool subject to regulation by Plaintiff either the pool entity itself or the "operator of the "pool" entity must clearly own an FCM account from which commodity interests are traded. 17 C.F.R. § 4.23 (a) (7) requires the following specific record keeping:

> "(7) Copies of each confirmation of a commodity interest transaction of the pool, each purchase and sale statement and each monthly statement for the pool *received from a futures commission merchant*." (Emphasis added).

The CFTC seeks to characterize defendant Equity as a CPO (for purposes of imposing liability upon Equity and thus upon defendants Shimer and Firth) even though (under the CFTC's own above cited record keeping regulations) it would be *virtually impossible* for Equity (even if it had registered with Plaintiff) to comply with the requirements of 17 C.F.R. § 4.23 (a) (7) in the absence of an FCM account opened in the name of the entity Shasta. Nor would it be possible (given the clear terms of Shasta's contractual relationship with defendant Tech) for Equity to provide any of the information typically requested by the CFTC from another entity (such as defendant Tech) alleged to have operated its "super fund" as a commodity pool[65].

[65] See for example ¶ 34, page 18 of Plaintiff's First amended Complaint.

4. It would have been virtually impossible for Shasta or its manager Equity to ever comply with the CPO Disclosure Requirements of 17 CFR § 4.24

Finally, the CFTC's regulations found at 17 CFR § 4.24 impose certain disclosures required to be made to prospective pool participants. 17 CFR § 4.24(s), for example, clearly anticipates that at a certain point in time pool entities will initiate the actual trading of "commodity interests" and requires that sort of information to be contained in the pool disclosure document:

> (s) *Inception of trading and other information*. (1) The minimum aggregate subscriptions that will be necessary for the pool *to commence trading commodity interests*. (Emphasis added).

Defendants Shimer and Firth respectfully suggest that the Court ask Plaintiff CFTC the following question: "Exactly when did Shasta (the alleged "commodity pool") or Shasta's alleged "operator" (Equity) ever commence 'trading commodity interests'"? Banking records can certainly fix the time that Shasta's funds were forwarded by Shimer on behalf of his client Shasta to defendant Tech's bank account at Bank of America. That act taken by defendant Shimer on behalf of his client Shasta clearly is not the act of "trading commodity interests" by Shasta. Nor can the Plaintiff argue that the trading of commodity interests by defendant Tech from an account in Tech's own name represents the trading of commodity interests by Shasta or by Equity for Shasta.[66] The only entity that ever traded "commodity interests" was defendant Tech.

If neither Shasta nor Equity have ever opened a commodity trading account at any FCM, and if Shasta is not a "pool" by reason of the specific definition of that term as found in the Plaintiff's own regulations, and if the Plaintiff cannot cite a single previous instance in which the federal courts have held an entity that does not own or control a commodity futures trading account at an FCM from which commodity interests can be traded (and that has *never represented to anyone* that it ever intends to open such an account to "trade commodity interests" *on behalf of anyone*) how is it possible for Equity to be cited by Plaintiff as an unregistered Commodity Pool Operator?

[66] Shasta's Investment Agreement with Tech did not allocate any commodity interest to Shasta by reason of that Agreement. That Agreement only required Tech to share whatever profits Tech earned as a result of Tech's trading of Tech's own account.

5. All of the above cited CFTC Regulations clearly assume and, therefore, require that a "commodity pool" or the pool's "operator" either engage in, be able to engage in or represent that it intends to engage in the regulated activity of commodity *trading* through an established FCM account.

In *every instance* in which the CFTC has charged an entity or individual with being a CPO (being the "operator" of a commodity pool) that entity or individual has essentially met the requirements of *Lopez* and has either opened a commodities trading account at an FCM and engaged in trading of commodity interests on behalf of the pool entity or, in the alternative has specifically hired a CTA (Commodity Trading Advisor) to trade a commodity account established *in the name of the pool entity for the benefit of the pool entity*. In several cases of fraudulent misrepresentation, the actual trading activity may not have actually occurred [see, for example, *CFTC v. Weinberg* 287 F.Supp.2d 1100 (C.D.Calif 2003)] but in every case the entity or person charged with violating the CEA as a CPO has at least *made the representation to prospective pool participants* that trading of their funds would occur in the name of and for the benefit of the pool entity that held their funds.

E. Plaintiff's Original Complaint Apparently Engaged In An Intentional Mischaracterization Of Critical And Necessary Facts With Respect To Shasta and Defendant Equity In An Apparent Attempt To "Fit" A Square Peg Into A Round Hole.

Prior to an examination of the Plaintiff's cited cases, (particularly *Lopez*) an objective observer familiar with the facts surrounding Shasta and its manager Equity might initially conclude that certain critical factual misstatements in Plaintiff's Original Complaint are easily explained away as the result of an incomplete or hasty investigation. A close examination of the language carefully chosen by Plaintiff in the Original Complaint filed with this Court on April 1, 2004 discloses the Division was well aware that an accurate description of the relationship between Shasta and Equity and Shasta and Tech would not support a finding that Shasta met the definition of a "commodity pool".

Plaintiff apparently inserted certain specific and deliberate factual misrepresentations into its Complaint filed on April 1, 2004 in a transparent attempt to justify its erroneous characterization of Shasta as a "commodity pool" and lend credence to its *Ex Parte* Motion for Statutory Restraining Order under the CEA filed with respect to all of the Equity Defendants including defendant Shimer.

1. Paragraph 23 Of Plaintiff's Original Complaint

In Section IV of its Original Complaint filed with the Court on April 1, 2004 and more specifically in ¶23 on page 8 of that Complaint (following its allegation that Equity and Firth solicited an investment "in the Shasta commodity pool") the Division makes the following carefully crafted and deliberate misstatement:

> "Since approximately June 2001, they have solicited investors *to purchase commodity futures contracts* using a "unique computerized approach called the 'Synergetic Portfolio Trading System.'" (Emphasis added)

The Division knew full well that the first part of the Lopez four part test previously described for finding that an entity is a commodity pool required: "(1) an investment organization in which the funds of various investors are solicited and combined into a single account *for the purpose of investing in commodity futures*" (Emphasis added). The Division can hardly claim it cited *Lopez* without ever reading the case.

The CFTC cannot refute the fact that Shasta's members were *never solicited* to "purchase commodity futures contracts" as alleged by the Division and anyone who can read the English language and who has reviewed Shasta's PPM and the subscription documents that accompanied Shasta's PPM knows full well that such a statement by the Division was not and is not true. Prior to his recent review of *Lopez*, Shimer and Firth both believed that this misstatement by Plaintiff was merely the result of an investigation cobbled together in haste in order to justifiably effect the court ordered freeze of significant assets found to exist in the trading account(s) and bank account(s) of defendant Tech.

A review of *Lopez* (cited by the Division in its Brief) now clearly indicates that the Division knew full well (despite its shoddy investigation of Shasta) that neither Shasta, nor Equity nor any member of Shasta *ever* "purchased commodity futures contracts".[67] The Division apparently decided it was "appropriate" to include such a fictional allegation in order to try and closely align the stated facts in its Complaint with the test required by *Lopez*. Nor can the Division claim with any credibility that this clear factual misstatement was made with lack of knowledge of the required test imposed by *Lopez* since the Plaintiff primarily cites *Lopez* in vain for its unfounded position that Shasta is a commodity pool.

[67] The Division was provided all of Shasta's subscription documents by one Mark Munson a prospective Shasta member during the course of its initial investigation.

2. Paragraph 24 of Plaintiff's Original Complaint

Turning to the very next paragraph (¶24 of the Original Complaint) the Division continues to "manipulate" the truth and the facts apparently with an eye toward the requirements of *Lopez*:

> "According to its Private Placement Memorandum, Equity also claims that *its trading system* called the 'Synergy Trading System' in the Private Placement Memorandum, has resulted in "astonishing performance". (Emphasis added)

This statement by the Division is not only false and untrue but inexcusably so. The Division can provide the Court with *not one example* where Equity, Shimer or Firth ever represented in writing to *anyone* that the Synergy Trading System belonged to or was operated by Equity. Shasta's PPM clearly discloses that all trading was to be done by the "Trading Company" (Defendant Tech).[68] All documentation prepared by Shimer for the benefit of his clients Shasta and Equity *never represented or even implied to anyone* that Equity owned a trading system or was in any way engaged in "operating" any "trading system". If it were not for

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[68] The copy of Shasta's PPM attached to the Division's Complaint as Exhibit A, tab 3 never represents that the Synergy Trading System belongs to defendant Equity. Just the opposite. Page 4 of that PPM (CFTC 300 02 007 when describing the "Business of the Company" states that "The Company shall place all funds, pursuant to a specific investment agreement with a certain private trading company (hereinafter "Trading Company"). The Trading Company provides the Company with access to a certain managed futures index trading "portfolio" system…"
Page 8 of Shasta's PPM (CFTC 300 02 0011) refers specifically to Shasta's investment with the Trading Company and explains that all trading is done in the name of the Trading Company and the fact that there is no account at any FCM opened in the name of Shasta. The section of Shasta's PPM entitled Summary of the Synergy Trading System (pages 8,9 & 10 of Shasta's PPM (CFTC 300 02 0011, 300 02 0012, & 300 02 0013 never states or implies that the described trading system belongs to Equity. All references are to the "developers". Not a single member of Shasta can truthfully say that they were under the impression that Equity owned or operated the Synergy Trading System.
Moreover Article I, paragraph 1.23 of the Company's Operating Agreement executed by every member defined Company Profits and Losses as follows: "Company Profits" and "Company Losses" means, for each fiscal year or other period specified in this Agreement, an amount equal to the Company's income as a result of profits generated by the Company's investment in the Trading Company and loss as a result of the losses sustained by that investment. Article II, paragraph 2.5 of the Company's operating agreement as well as Shasta's PPM clearly disclosed that access to the "Trading System" was only made possible to Shasta as a result of the Investment Agreement that Shasta had signed with the Trading Company.
Finally the second recital in that certain document entitled Agreement for Independent Verification of Shasta Capital Profits and Losses (a document that was an *essential part* of *every* subscription package provided to *every* prospective member of Shasta but virtually ignored and therefore curiously never referred to anywhere by the Division) in its second recital referred to "certain performance information with respect to a certain privately managed index futures trading "portfolio" system known as the Synergetic-Portfolio Trading System made available to the Company by a certain company described in the above Memorandum as the "Trading Company").

Lopez one might again conclude (after reading ¶ 24) that the Division's lead trial attorney and its investigator were just innocently hallucinating when the Original Complaint was drafted.

3. <u>Paragraph 25 Of Plaintiff's Original Complaint</u>

In Section IV of its Original Complaint filed with the Court on April 1, 2004 and more specifically in ¶25 on page 9 the Division again takes deliberate liberty with the truth by trying to characterize the returns posted on Shasta's web site as a representation of earnings by Shasta:

> "On the http://www.shastacapitalassociates.com/ web site, Equity claims that Shasta has earned returns of as much as 30.19% and no less than 9% for every month since January 2001."

Again if it were not for the applicability of the four part test required by *Lopez* one might be convinced that the Division was just confused and, again, innocently "just got the facts wrong" (a stinging indictment of Plaintiff's behavior in and of itself). Plaintiff *knew or should have known* the performance numbers cited above by the Division in the Plaintiff's Original Complaint were stated *performance numbers of the Synergy Trading System itself (owned and operated by the "Trading Company--defendant Tech Traders)—not* monthly returns of Shasta.

The Division's Original complaint is clearly a document filed with this Court that arguably contains intentionally false factual statements—not statements made in innocence or incompetence as a result of haste. It is outrageous that a Federal Agency with the broad enforcement authority granted to the CFTC by Congress should use its enforcement authority to mischaracterize the activity of defendant Shimer's clients Shasta and Equity and thus brand innocent private citizens such as Shimer and Firth as perpetrators of a fraud.[69]

[69] **It is even more outrageous and unacceptable that the Division's investigator and lead trial attorney should make these clear and obvious misrepresentations with respect to Equity in combination with the Division's attempt to falsely allege (by the use of clever "implication") that Shimer was responsible for a $5.3 million short fall between what should have been forwarded to Tech from his attorney escrow account and what was actually forwarded to Tech. See previous footnote 38, found on Page 27 of this Brief.**

VI. PLAINTIFF CFTC HAS FAILED TO MEET ITS BURDEN OF ESTABLISHING SUBJECT MATTER JURISDICTION WITH RESPECT TO ALL ALLEGED VIOLATIONS OF THE COMMMODITY EXCHANGE ACT 7 U.S.C. §§ 1 AS STATED IN COUNTS I-IV OF PLAINTIFF'S FIRST AMENDED COMPLAINT WITH RESPECT TO SHIMER, FIRTH AND EQUITY AND, THERFORE, DEFENDANT'S MOTION TO DISMISS FOR LACK OF SUBJECT MATTER JURISDICTION UNDER FEDERAL RULE 12(b)(1) SHOULD BE GRANTED. IN THE ALTERNATIVE, THAT DEFENDANT EQUITY IS NOT A CPO BY REASON OF THE FACT THAT SHASTA IS NOT A COMMODITY POOL IS AN APPROPRIATE BASIS TO GRANT DEFENDANT'S MOTION UNDER FEDERAL RULE 12(b)6 BECAUSE PLAINTIFF HAS FAILED TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED.

A. Plaintiff CFTC Clearly Has The Burden Of Establishing Subject Matter Jurisdiction

It is without question that the burden of establishing subject matter jurisdiction with respect to all of the Equity Defendants is upon the CFTC. See *CFTC v. Clothier*, 788 F.Supp 492 (D.Kan 1992) also citing *Miller v. United States*, 710 F.2d 656, 662 (10th Cir.), *cert denied*, 464 U.S. 939, 104 S. Ct. 352, 78 L.Ed.2d 316 (1983); *Baird v. United States*, 653 F.2d 437, 440 (10th Cir. 1981).

B. Defendant's Motion To Dismiss For Lack Of Subject Matter Jurisdiction Under Federal Rule 12(b)(1) is Appropriate and Should Be Granted With Respect To All Alleged Violations Of Section 4b(a)(2), Section 13(b) And Section 2(a)(1)(B) Of The Commodity Exchange Act With Respect To The Equity Defendants. In the Alternative, Defendant's Motion To Dismiss Under Federal Rule 12(b)6 With Respect To All Of The Above Alleged Violations should be Granted.

Quoting verbatim from footnote 9 on page 15 of Plaintiff's own Brief previously filed with this court in support for its *Ex Parte* Statutory Restraining Order and Preliminary Injunction:

> "Section 4b of the Act, 7 U.S.C. § 6b(a)(2)(i), provides in pertinent part that '[i]t shall be unlawful…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 person… (i) to cheat or defraud such other person…" . (Emphasis added).

On that same page 15, the CFTC also succinctly and correctly summarizes the cited statute by stating that

> "Section 4b of the Act prohibits cheating and defrauding or attempting to defraud or willfully deceiving or attempting to deceive other persons

in connection with commodity futures trading for or on behalf of such persons." (Emphasis added). [70]

In the very next sentence of its Brief Plaintiff then alleges a violation of Section 4b(a)(2) by claiming that

> "Defendants Equity and Firth have defrauded *commodity pool participants* by misrepresenting the performance of *the pool*"[71]; (Emphasis added)

and, furthermore, Plaintiff claims in its First Amended Complaint that

> "From at least January 2002 to the present, Equity, Shimer and Firth have cheated or defrauded or attempted to cheat or defraud and willfully deceived or attempted to deceive *pool participants or prospective pool participants* by misrepresenting the performance of the commodity pool"[72] and that the "actions and omissions of Firth and Shimer" were allegedly performed "within the scope of their employment with Equity" and that, therefore "Equity is also liable for Firth's and Shimer's violations of Section 4b(2)(i)(iii) of the Act, pursuant to Section 2(a(1)(B) of the Act, 7 U.S.C. § 2a(1)(B)"[73]; (Emphasis added)

and, furthermore, Plaintiff claims in its First Amended Complaint that

> "Firth and Shimer directly or indirectly controlled Equity and did not act in good faith or knowingly induced, directly or indirectly, the acts constituting Equity's violations alleged in this count (count I)" and that "Firth and Shimer are thereby liable for Equity's violations of section 4b(a)(2)(i)-(iii) of the Act, pursuant to Section 13(b) of the Act, 7 U.S.C. § 13c(b).[74]

Plaintiff CFTC's above cited alleged violations by defendants Shimer, Firth and Equity *are all precariously dependent upon and inextricably linked to the Plaintiff's inaccurate claim that Shasta is a "commodity pool" and that Equity is the "operator" of that pool*.

In the absence of a finding by this court that Shasta is a commodity pool per the four part test of *Lopez*, Equity cannot, as a matter of law, be considered to be the "operator" of a commodity pool. As previously discussed, the controlling case law of *Lopez v. Dean Witter Reynolds, Inc*., 805 F.2d 880 (9th Cir. 1986) and the CFTC's own regulations *do not* support

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[70] Brief in Support of Plaintiff's Motion for *Ex Parte* Statutory Restraining Order and Preliminary Injunction, p. 15
[71] Brief in Support of Plaintiff's Motion for *Ex Parte* Statutory Restraining Order and Preliminary Injunction, p. 15.
[72] See First Amended Complaint, ¶ 57.
[73] See First Amended Complaint, ¶ 58.
[74] See First Amended Complaint, ¶ 59.

such a finding by this court. The case law and the CFTC's regulations specifically require a contrary conclusion.

In the absence of a finding by this court that Equity is a commodity pool operator subject matter jurisdiction does not exist with respect to Plaintiff's claim that defendant Shimer violated Sections 4b(a)(2) or Section 13(b) of the Commodity Exchange Act as alleged in Count I of Plaintiff's First Amended Complaint. Defendant Shimer's Motion To Dismiss For Lack Of Subject Matter Jurisdiction should be granted as a matter of law with respect to:

1) any claim by Plaintiff that Shimer cheated or attempted to cheat or defraud *commodity pool participants* directly in violation Section 4b(a)(2) of the Commodity Exchange Act; and,
2) any claim by Plaintiff that pursuant 13(b) of the Commodity Exchange Act, 7 U.S.C. § 13c(b) Shimer cheated or attempted to cheat or defraud *commodity pool participants* or that he did so within the scope of his employment for Equity and is therefore liable for Equity's violation of Section 4b(a)(2) of the Commodity Exchange Act (CEA) as alleged in Count I of Plaintiff's First Amended Complaint.

Alternatively, in the absence of a finding by this court that Equity is a commodity pool operator Defendant's Shimer's Motion to Dismiss under Federal Rule 12(b)6 with respect to all of the above cited allegations by Plaintiff is appropriate and should be granted.

Similarly, in the absence of a finding by this court that Equity is a commodity pool operator subject matter jurisdiction does not exist with respect to Plaintiff's claim that defendant Firth directly violated Sections 4b(a)(2) or Section 13(b) of the Commodity Exchange Act as alleged in Count I of Plaintiff's First Amended Complaint. Defendant Firth's Motion to Dismiss For Lack Of Subject Matter Jurisdiction is appropriate and should be granted as a matter of law with respect to:

1) any claim by Plaintiff that Firth cheated or attempted to cheat or defraud *commodity pool participants* directly in violation Section 4b(a)(2) of the Commodity Exchange Act; and,
2) any claim by Plaintiff that pursuant 13(b) of the Commodity Exchange Act, 7 U.S.C. § 13c(b) Firth cheated or attempted to cheat or defraud *commodity pool participants* or that he did so within the scope of his employment for Equity and is therefore liable

for Equity's violation of Section 4b(a)(2) of the Commodity Exchange Act (CEA) as alleged in Count I of Plaintiff's First Amended Complaint.

Alternatively, in the absence of a finding by this Court that Equity is a commodity pool operator Defendant's Firth's Motion to Dismiss under Federal Rule 12(b)6 with respect to all of the above cited allegations by Plaintiff is appropriate and should be granted.

Similarly, in the absence of a finding by this Court that Equity is a commodity pool operator subject matter jurisdiction does not exist with respect to Plaintiff's claim that defendant Equity directly violated Section 4b(a)(2) or Section 2(a)(1)(B) of the Commodity Exchange Act as alleged in Count I of Plaintiff's First Amended Complaint. If defendant Equity's legal counsel later files a Motion To Dismiss For Lack Of Subject Matter Jurisdiction on behalf of Equity with respect to Plaintiff's claim that Equity cheated or attempted to cheat or defraud *commodity pool participants* directly in violation Section 4b(a)(2) of the Commodity Exchange Act or that pursuant to Section 2(a)(1)(B) of the Commodity Exchange Act 7 U.S.C. § 2a(1)(B) Equity is liable for Firth's and Shimer's alleged violations of Section 4b(a)(2) of the Act said Motion To Dismiss on behalf of defendant Equity should be granted.

Alternatively, in the absence of a finding by this court that Equity is a commodity pool operator, should defendant Equity's legal counsel later decide to file a Motion under Federal Rule 12(b)6 with respect to all of the above cited allegations by Plaintiff with respect to defendant Equity, such a Motion on behalf of defendant Equity would be appropriate and such a Motion under Rule 12(b)6 by Equity's legal counsel should be granted.

C. A Motion To Dismiss For Lack Of Subject Matter Jurisdiction Under Federal Rule 12(b)(1)Is Appropriate With Respect To Defendant's Alleged Violation of Section 4*o*(1) Of The Commodity Exchange Act And Defendant's Motion To Dismiss Should Be Granted. In the Alternative, Defendant's Motion To Dismiss Under Federal Rule 12(b)6 With Respect To The Alleged Violation of Section 4*o*(1) should be Granted.

Section 4*o*(1) of the CEA specifically prohibits fraud and misrepresentation by commodity trading advisors ("CTAs") and commodity pool operators ("CPOs") and their associated persons ("APs"). 7 U.S.C. § 6*o* (2001). Sections 4*o*(1)(A) and (B) of the Act make it unlawful *for a CPO or a CTA or their APs* by use of the mails or interstate commerce to employ any device, scheme, or artifice to defraud any client or prospective client or participant or to

engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant.

Plaintiff's Brief filed previously with this Court claims that defendant Equity was acting as a CPO with respect to Shasta and therefore is liable for alleged violation of Section 4*o*(1) of the CEA and that Firth as an alleged AP of Equity is similarly liable under that same section. Plaintiff also correctly points out in its Brief, that critical to finding a violation of Section 4*o*(1) has occurred, *there must be a finding that the alleged violator is either a CTA, CPO or an AP of either entity*. *Davis v. Coopers & Lybrand*, 797 F. Supp. 797, 798 (N.D. Ill. 1992). [75] (Emphasis added).

Plaintiff's First Amended Complaint alleges that "[d]uring the relevant time period Equity acted as a CPO…".[76] Plaintiff's First Amended Complaint further alleges that both defendants

> "Firth and Shimer acted as APs to Equity.[77]

Plaintiff further alleges

> that "From at least January 2002 through the present Equity, Firth and Shimer have violated Section 4*o*(1) of the Act, 7 U.S.C. § 6*o*(1) in that they directly or indirectly employed or are employing a device, scheme or artifice *to defraud commodity pool participants*, or have engaged or is (*sic*) engaging in transactions, practices or a course of business which operated as a fraud or deceit *upon commodity pool participants*…". [78] (Emphasis added)

Plaintiff further alleges in its First Amended Complaint that

> "[t]he actions and omissions of Firth and Shimer described in this count (count II) were done within the scope of their employment with Equity. Therefore, Equity is also liable for Firth's and Shimer's violations of Section 4*o*(1) of the Act pursuant to Section 2(a)(1)(B) of the Act, 7 U.S.C. § 2a(1)(B).[79]

And finally, Plaintiff alleges in its First Amended Complaint that

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[75] Brief in Support of Plaintiff's Motion for *Ex Parte* Statutory Restraining Order and Preliminary Injunction, pp 18 & 19 referencing *Davis*.
[76] See First Amended Complaint, ¶ 72.
[77] See First Amended Complaint, ¶ 73.
[78] See First Amended Complaint, ¶ 74.
[79] See First Amended Complaint, ¶ 75.

> "Firth and Shimer, directly or indirectly, controlled Equity and did not act in good faith or knowingly induced, the acts constituting Equity's violations alleged in this count (count II). Firth and Shimer are thereby liable for Equity's violations of Section 4*o*(1), pursuant to Section 13(b) of the Act, 7 U.S.C. § 13c(b).[80]

Plaintiff CFTC's allegations of any violation by defendants Shimer, Firth or Equity with respect to Section 4*o*(1) and Section 13(b) of the Act are precariously dependent upon and inextricably linked to the Plaintiff's inaccurate claim that Shasta is a "commodity pool" and that Equity is the "operator" of that pool. By reason of the reasonable and proper four part test enunciated by *Lopez* Equity is not a CPO and therefore defendants Shimer, Firth and Equity did not act in violation of either Section 4*o*(1) or 13(b) of the Act.

In the absence of a finding by this court that Shasta is a "commodity pool" per the four part test of *Lopez*, Equity cannot, as a matter of law, be considered to be the "operator" of a commodity pool. As previously discussed, the controlling case law of *Lopez v. Dean Witter Reynolds, Inc*., 805 F.2d 880 (9th Cir. 1986) and the CFTC's own regulations *do not* support such a finding by this court. The case law and the CFTC's regulations specifically require a contrary conclusion.

In the absence of a finding by this court that Equity is a commodity pool operator subject matter jurisdiction does not exist with respect Plaintiff's allegation that defendant Shimer violated either Section 4o(1) or Section 13(b) of the Commodity Exchange Act as alleged in Count II of Plaintiff's First Amended Complaint. Shimer's Motion to Dismiss is, therefore, appropriate and defendant Shimer's Motion To Dismiss For Lack OF Subject Matter Jurisdiction under Federal Rule 12(b)(1) should be granted as a matter of law with respect to:

1) any claim by Plaintiff that Shimer directly or indirectly employed a device or scheme to defraud *commodity pool participants* in violation Section 4*o*(1) of the Commodity Exchange Act, 7 U.S.C. § 6*o*(1); and,
2) any claim by Plaintiff that pursuant 13(b) of the Commodity Exchange Act, 7 U.S.C. § 13c(b) Shimer directly or indirectly controlled Equity and thereby induced Equity's violation of Section 4*o*(1) of the CEA as alleged in Count II of Plaintiff's First Amended Complaint.

[80] See First Amended Complaint, ¶ 76.

Alternatively, in the absence of a finding by this Court that Equity is a commodity pool operator Defendant's Shimer's Motion to Dismiss under Federal Rule 12(b)6 with respect to all of the above cited allegations by Plaintiff is appropriate and should be granted.

In the absence of a finding by this court that Equity is a commodity pool operator subject matter jurisdiction does not exist with respect to Plaintiff's allegation that defendant Firth violated either Section 4o(1) or Section 13(b)of the Commodity Exchange Act as alleged in Count II of Plaintiff's First Amended Complaint. Defendant Firth's Motion To Dismiss is appropriate and defendant Firth's Motion To Dismiss For Lack Of Subject Matter Jurisdiction pursuant to Federal Rule 12(b)(1) should be granted as a matter of law with respect to:

1) any claim by Plaintiff that Firth directly or indirectly employed a device or scheme to defraud *commodity pool participants* in violation Section 4*o*(1) of the Commodity Exchange Act, 7 U.S.C. § 6*o*(1); and,
2) any claim by Plaintiff that pursuant 13(b) of the Commodity Exchange Act, 7 U.S.C. § 13c(b) Firth directly or indirectly controlled Equity and thereby induced Equity's violation of Section 4*o*(1) of the CEA as alleged in Count II of Plaintiff's First Amended Complaint.

Alternatively, in the absence of a finding by this Court that Equity is a commodity pool operator Defendant's Firth's Motion to Dismiss under Federal Rule 12(b)6 with respect to all of the above cited allegations by Plaintiff is appropriate and should be granted.

Similarly, in the absence of a finding by this court that Equity is a commodity pool operator subject matter jurisdiction does not exist with respect to Plaintiff's allegation that defendant Equity violated either Section 4*o*(1) or Section 2(a)(1)(B) of the Commodity Exchange Act as alleged in Count II of Plaintiff's First Amended Complaint. A similar Motion To Dismiss under Federal Rule 12(b)(1) would, therefore, be appropriate and if defendant Equity's legal counsel later files a Motion To Dismiss For Lack Of Subject Matter Jurisdiction on behalf of Equity with respect to Plaintiff's claim that Equity directly or indirectly employed any device or scheme to defraud *commodity pool participants* in violation Section 4*o*(1) of the Commodity Exchange Act (or, that pursuant to Section 2(a)(1)(B) of the Commodity Exchange Act 7 U.S.C. § 2a(1)(B) Equity is liable for Firth's and Shimer's alleged violations of Section 4*o*(1) of the Act) said Motion on behalf of defendant Equity should be granted.

Alternatively, in the absence of a finding by this Court that Equity is a commodity pool operator, should defendant's Equity's legal counsel later decide to file a Motion to Dismiss under Federal Rule 12(b)6 with respect to the above cited allegations by Plaintiff with respect to defendant Equity, such a Motion, if filed by defendant Equity's legal counsel would be appropriate and should be granted.

D. <u>A Motion To Dismiss For Lack Of Subject Matter Jurisdiction Under Federal Rule 12(b)(1) Is Appropriate With Respect To Any Alleged Violation Of Section 4m(1), Section 13(b) and Section 13(a) Of The CEA And Defendant's Said Motion To Dismiss Should Be Granted. In the Alternative, Defendant's Motion To Dismiss Under Federal Rule 12(b)6 With Respect To Any Of The Cited Alleged Violations Is Appropriate And Defendant's Motion For Summary Judgment Should Be Granted.</u>

As specifically cited by Plaintiff in its Brief,

> "Section 4m(1) of the Act provides that it shall be unlawful for any commodity trading advisor or commodity pool operator, unless registered under this chapter, to make use of the mails or any means or instrumentality of interstate commerce in connection with his business as such commodity trading advisor or commodity pool operator." 7 U.S.C. § 6m(1) (2001).[81]

In its First Amended Complaint the CFTC asserts that

> "Equity acted as a CPO, used the mails and other means or instrumentalities of interstate commerce, directly or indirectly, to engage in business as a CPO without the benefit of registration, in violation of Section 4m(1) of the Act, 7 U.S.C. § 6m(1) (2002)."[82]

Plaintiff CFTC further alleges in its First Amended Complaint that:

> "Firth and Shimer, directly or indirectly, controlled Equity and did not act in good faith or knowingly induced, directly or indirectly, the acts constituting Equity's violations alleged in this count. Firth and Shimer are thereby liable for Equity's violations of Section 4m(1), pursuant to Section 13(b) of the Act, 7 U.S.C. § 13c(b)."[83]

Plaintiff also further alleges as a part of Count III of its First Amended Complaint that:

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[81] Brief in Support of Plaintiff's Motion for *Ex Parte* Statutory Restraining Order and Preliminary Injunction. (See footnote 12 of that Brief on page 19).

[82] See First Amended Complaint, ¶ 79.

[83] See First Amended Complaint, ¶ 80.

> Shimer accepted Shasta participants funds in an escrow account entitled Robert W. Shimer escrow, attorney account, Shasta Capital Associates, LLC on behalf of Equity, an unregistered CPO. Consequently Shimer willfully …aided and abetted… the commission of Equity's violation of Section 4m(1) of the act…and is liable for the violations of Section 4m(1) of the Act by Equity as a principal pursuant to Section 13(a) of the Act, 7 U.S.C. § 13c(a).[84]

The allegation by Plaintiff that Equity violated Section 4m(1) of the Act is dependent upon and is inextricably linked to Plaintiff's inaccurate claim that Shasta is a "commodity pool" and that Equity is, therefore, the "operator" of that pool. Absent a finding that Shasta is a commodity pool, Equity is not a CPO and therefore did not violate Section 4m(1) of the Act nor, absent such a finding, did Shimer and Firth violate Section 13(b) of the Act for inducing as an alleged controlling person of Equity, Equity's alleged violation of Section 4m(1). Likewise, absent a finding that Shasta is a "commodity pool" of which Equity is the "operator" Shimer did not violate Section 13(a) of the act by allegedly aiding and abetting Equity's alleged violation of Section 4m(1).

In the absence of a finding by this Court that Shasta is a "commodity pool" per the four part test of *Lopez*, Equity cannot, as a matter of law, be considered to be the "operator" of a commodity pool. As previously discussed, the controlling case law of *Lopez v. Dean Witter Reynolds, Inc*., 805 F.2d 880 (9th Cir. 1986) and the CFTC's own regulations *do not* support such a finding by this court. The case law and the CFTC's regulations specifically require a contrary conclusion.

In the absence of a finding by this Court that Equity is a commodity pool operator, subject matter does not exist with respect to defendant Equity and, therefore, A Motion To Dismiss pursuant to Federal Rule 12(b)(1) with respect to the allegation contained in Count III of Plaintiff's First Amended Complaint that Equity violated Section 4m(1) is appropriate. If defendant Equity's legal counsel later files such a Motion on behalf of Equity with respect to Plaintiff's claim that Equity used the mails directly or indirectly to engage in the business of a CPO allegedly without registration in violation Section 4m(1) of the Commodity Exchange Act 7 U.S.C. § 6m(1) as alleged in Count III of Plaintiff's First Amended Complaint said Motion To Dismiss under Federal Rule 12(b)(1) on behalf of defendant Equity should be granted.

[84] See First Amended Complaint, ¶ 81.

Alternatively, in the absence of a finding by this Court that Equity is a commodity pool operator, should defendant's Equity's legal counsel later decide to file a Motion to Dismiss under Federal Rule 12(b)6 with respect to the above cited allegations by Plaintiff with respect to defendant Equity, such a Motion, if filed by defendant Equity's legal counsel would be appropriate and should be granted.

In the absence of a finding by this Court that Equity is a commodity pool operator, subject matter does not exist with respect to defendant Shimer and, therefore, with respect to the allegations that Shimer violated Section 13(b) of the Commodity Exchange Act in that Shimer induced Equity's violation of Section 4m(1) of the Act or that Shimer violated Section 13(a) of the Commodity Exchange Act in that Shimer aided and abetted Equity's violation of Section 4m(1) of the Act as alleged in Count III of Plaintiff's First Amended Complaint defendant Shimer's Motion To Dismiss under Federal Rule 12(b)(1) is appropriate. Shimer's Motion To Dismiss under Federal Rule 12(b)(1) should be granted as a matter of law with respect to:

1) Plaintiff's allegation in Count III of Plaintiff's First Amended Complaint that Shimer violated Section 13(b) of the Act by directly or indirectly inducing Equity's alleged violation of Section 4m(1) of the Commodity Exchange Act by failing to register as a Commodity Pool Operator; and,
2) Plaintiff's allegation in Count III of Plaintiff's First Amended Complaint that Shimer violated Section 13(a) of the Act by aiding and abetting Equity's alleged violation of Section 4m(1) of the Commodity Exchange Act by failing to register as a Commodity Pool Operator.

Alternatively, in the absence of a finding by this Court that Equity is a commodity pool operator, defendant Shimer's Motion to Dismiss under Federal Rule 12(b)6 with respect to the above cited allegations by Plaintiff with respect to defendant Shimer is appropriate and such a Motion To Dismiss by Defendant Shimer should be granted.

Similarly, in the absence of a finding by this Court that Equity is a commodity pool operator, subject matter does not exist with respect to defendant Firth and, therefore, a Motion to Dismiss under Federal Rule 12(b)(1) with respect to the allegation that Firth violated Section 13(b) of the Commodity Exchange Act in that Firth induced Equity's violation of Section 4m(1) is appropriate. Firth's Motion To Dismiss under Federal Rule 12(b)(1) should be granted as a matter of law with respect to Plaintiff's claim that Firth violated Section 13(b) of the Act by

directly or indirectly inducing Equity's alleged violation of Section 4m(1) of the Commodity Exchange Act by failing to register as a Commodity Pool Operator as alleged in Count III of Plaintiff's First Amended Complaint.

Alternatively, in the absence of a finding by this Court that Equity is a commodity pool operator, defendant Firth's Motion to Dismiss under Federal Rule 12(b)6 with respect to the above cited allegations by Plaintiff with respect to defendant Firth is appropriate and such a Motion To Dismiss by Firth should be granted.

E. A Motion To Dismiss For Lack Of Subject Matter Jurisdiction Under Federal Rule 12(b)(1) Is Appropriate With Respect To Any Alleged Violation Of Section 4k(2) Of The Commodity Exchange Act And Defendant's Said Motion To Dismiss Should Be Granted. In the Alternative, Defendant's Motion To Dismiss Under Federal Rule 12(b)6 With Respect To The Cited Alleged Violation Of Section 4k(2) Is Appropriate And Defendant's Motion To Dismiss Should Be Granted

Plaintiff's Brief states that

> "Section 4k(2) of the Act makes it unlawful for any person to be associated with a CPO as a partner, officer, employee, consultant, or agent…that involves: (i) the solicitation of funds, securities, or property *for participation in a commodity pool*; or (ii) the supervision of any person or persons so engaged, unless such person is registered under the Act as an associated person of the CPO." [85] (Emphasis added)

Plaintiff's First Amended Complaint alleges:

> "During the relevant time period Firth and Shimer were each associated with Equity, a CPO, as a partner, officer, employee, consultant or agent (or a similar status), in a capacity that involved the solicitation of funds, securities or property *for participation in Shasta, a commodity pool without the benefit of registration*, in violation of Section 4k(2) of the Act 7 U.S.C. § 6k(2) (2001).[86] (Emphasis added)

Plaintiff's First Amended Complaint further alleges:

> "The actions and omissions of Firth and Shimer described in this count (count IV) were done within the scope of their respective employment with Equity. Therefore, Equity is

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[85] Brief in Support of Plaintiff's Motion for *Ex Parte* Statutory Restraining Order and Preliminary Injunction. (Page 21).

[86] See First Amended Complaint, ¶ 86.

> also liable for Firth's and Shimer's violations of Section 4k(2) of the Act pursuant to Section 2(a)(1)(B) of the Act, 7 U.S.C. § 2a(1)(B).[87]

The allegation by Plaintiff that Equity violated Section 4k(2) of the Act is dependent upon and is inextricably linked to Plaintiff's inaccurate claim that Shasta is a "commodity pool" and that Equity is, therefore, the "operator" of that pool. Absent a finding that Shasta is a commodity pool, Equity is not a CPO and therefore Shimer and Firth did not violate Section 4k(2) of the Act.

In the absence of a finding by this Court that Shasta is a "commodity pool" per the four part test of *Lopez*, Equity cannot, as a matter of law, be considered to be a commodity pool operator. As previously discussed, the controlling case law of *Lopez v. Dean Witter Reynolds, Inc*., 805 F.2d 880 (9th Cir. 1986) and the CFTC's own regulations *do not* support such a finding by this court. The case law and the CFTC's regulations specifically require a contrary conclusion.

In the absence of a finding by this court that Equity is a commodity pool operator, subject matter does not exist with respect to defendant Shimer and a Motion To Dismiss pursuant to Federal Rule 12(b)(1) is appropriate with respect to Plaintiff's allegation that Shimer failed to register as an Associated Person of defendant Equity in violation of Section 4k(2) of the Commodity Exchange Act 7 U.S.C. § 6k(2) as alleged in Count IV of Plaintiff's First Amended Complaint. Shimer's Motion To Dismiss under Federal Rule 12(b)(1) with respect to Plaintiff's allegation as contained in Count IV of Plaintiff's First Amended Complaint that Shimer violated Section 4k(2) of the Commodity Exchange Act 7 U.S.C. § 6k(2) should be granted.

Alternatively, in the absence of a finding by this Court that Equity is a commodity pool operator, defendant Shimer's Motion to Dismiss under Federal Rule 12(b)6 with respect to the above cited allegation by Plaintiff with respect to defendant Shimer is appropriate and such a Motion To Dismiss by Defendant Shimer should be granted.

In the absence of a finding by this court that Equity is a commodity pool operator, subject matter does not exist with respect to defendant Firth and a Motion To Dismiss pursuant to Federal Rule 12(b)(1) is appropriate with respect to Plaintiff's allegation that Firth failed to register as an Associated Person of defendant Equity in violation of Section 4k(2) of the Commodity Exchange Act 7 U.S.C. § 6k(2) as alleged in Count IV of Plaintiff's First Amended Complaint.. Firth's Motion To Dismiss under Federal Rule 12(b)(1) with respect to Plaintiff's

[87] See First Amended Complaint, ¶ 87.

allegation as contained in Count IV of Plaintiff's First Amended Complaint that Firth violated Section 4k(2) of the Commodity Exchange Act 7 U.S.C. § 6k(2) should be granted.

Alternatively, in the absence of a finding by this Court that Equity is a commodity pool operator, defendant Firth's Motion to Dismiss under Federal Rule 12(b)6 with respect to the above cited allegations by Plaintiff with respect to defendant Firth is appropriate and such a Motion To Dismiss by Defendant Firth should be granted.

VII. WITH RESPECT TO COUNT V OF PLAINTIFF'S FIRST AMENDED COMPLAINT

A. Plaintiff Departs From Its Prior Allegation That Tech Acted As A CTA Primarily With Respect To Its Own Super Fund Account.

Plaintiff first begins the paragraphs of Count V of its First Amended Complaint with a litany of allegations offered in support for Plaintiff's proposition that the "super fund" account from which Tech conducted all trading was, in effect a "pool" and, that defendant Tech, as the "operator" of the "super funds" pool commingled property of that pool with the property of its own and others in violation of Regulation 4.20(c), 17 C.F.R. § 4.20(c).[88]

In Count V, paragraphs 95 through 97 Plaintiff's First Amended Complaint further alleges that Tech, in its capacity as an alleged CPO, violated Regulation 4.21 17 C.F.R. § 4.21 by failing to timely provide "prospective pool participants" with the Disclosure Documents as required by Regulations 4.24 and 4.25, 17 C.F.R. §§ 4.24 and 4.25. Paragraphs 98 through 100 allege that Tech, in its capacity as an alleged CPO, violated Regulation 4.22, 17 C.F.R. § 4.22, by failing to provide required Account Statements to pool participants.

In paragraph 101 Plaintiff suddenly switches Count V "theories" with respect to Tech, apparently for the sole purpose of alleging a violation of Section 13(a) of the Act by Shimer. But since Commission Regulation 4.30 only applies to violations by CTAs, Plaintiff's adopted new "theory" is that *Tech also acted as a CTA with respect to Shimer's client Shasta*:

> "Tech Traders was the CTA for Shasta and others in that, for compensation or profit, it advised the *Shasta commodity pool* and others as to the advisability of trading in commodity futures contracts."[89] (Emphasis added)

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[88] See First Amended Complaint, ¶s 92-94

[89] See First Amended Complaint, ¶ 102.

According to Plaintiff's new alternate "theory", Shasta is the "pool" and Tech the alleged CTA to that pool. An examination of the entire First Amended Complaint filed by Plaintiff discloses that its primary theory of CEA liability with respect to Tech is that Tech generally acted as a CPO with respect to its "super fund" account.[90] In a paragraphs 34 and 64 of the First Amended Complaint Plaintiff does make passing reference to its theory that Tech acted as a CTA though it is clear that prior to Plaintiff's transparent Count V effort with respect to Shimer Plaintiff's "CTA theory" with respect to Tech (other than the obvious role Tech played with respect to a particular Sterling account)[91] is actually couched solely in terms of Tech's role with respect to its own super fund account. In prior pages of its First Amended Complaint we find Plaintiff stating, with respect to Tech:

> "It acted as a CTA by making trading decisions for the "super fund" commodity pool and exercising power of attorney over at least one third party commodity futures trading account."[92]

B. Defendant Shimer Is Entitled To Summary Judgment With Respect to Count V Of Plaintiff's First Amended Complaint Because Shimer Did Not Violate Section 13(a) Of the Commodity Exchange Act For The Reason That Defendant Tech Was Not Shasta's CTA And, Therefore, Tech Did Not Violate Regulation 4.30 by Reason Of Its Relationship To Shasta.

There are two obvious and fatal flaws to Plaintiff's attempt to characterize Tech as a CTA of Shasta.

1. *Lopez* is the first fatal flaw in Plaintiff's theory that Tech acted as Shasta's CTA

The first flaw in Plaintiff's statement found in Paragraph 102 which attempts to claim that "Tech is the CTA of Shasta" is the fact that, as a matter of law, Shasta is not a "commodity pool" because Shasta clearly does not meet the required four part test of *Lopez v. Dean Witter Reynolds, Inc.*, 805 F.2d 880 (9th Cir. 1986).[93] As previously pointed out, *Lopez* was cited with approval by Plaintiff in its Brief. Therefore the "commodity pool" entity that Tech purportedly

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[90] See ¶s 4, 6a, 34, 54, 63,
[91] See CFTC 100 02 0010 (Agreement by and between Murray's company Tech Traders, Ltd and Sterling Trust (Anguilla), Ltd. which conferred upon Tech "discretionary trading authority over account 37923 at GNI INC brokerage firm…"
[92] See First Amended Complaint, ¶ 34, page 18.
[93] See previous extensive discussion and analysis of *Lopez* beginning on page 48.

"advised" as to the "advisability of trading in commodity futures" is not a commodity pool at all as a matter of controlling case law.

To the extent that the truth of Plaintiff's conclusion in paragraph 102 that "Tech is a CTA" is dependent upon the truth of its statement in that same paragraph that Shasta is a "commodity pool", Plaintiff's contention that Tech is the CTA of Shasta cannot be sustained. If Tech is not the CTA of Shasta by reason of the fact that Shasta is not a "commodity pool", then Tech did not violate Regulation 4.30, 17 CFR § 4.30 in connection with its relationship to Shasta and, therefore, Summary Judgment is appropriate for Shimer with respect to Plaintiff's allegation that Shimer aided and abetted Tech's violation of Regulation 4.30 in violation of Section 13(a) of the Commodity Exchange Act as alleged in Count V of Plaintiff's First Amended Complaint. Shimer's Motion for Summary Judgment with respect to Plaintiff's allegation as contained in Count V of Plaintiff's First Amended Complaint that Shimer violated Section 13(a) of the Commodity Exchange Act by aiding and abetting Tech's violation of Regulation 4.30 should, therefore, be granted.

2. **Fatal flaw #2: The CFTC is constrained by case law to the clear and unambiguous statutory definition of a CTA which does not describe the relationship that existed between Tech and Shasta.**

The best place to start when attempting to determine if an entity meets the definition of Commodity Trading Advisor is to obviously examine the underlying statute. The statutory definition of a CTA is found at 7 U.S.C. § 1a(6) which states in relevant part:

> "… the term "commodity trading advisor" means any person who (i) for compensation or profit, engages in the business of *advising others*, either directly or through publications, writings, or electronic media, *as to the value* of or the *advisability of trading in -(I) any contract of sale of a commodity for future delivery* made or to be made on or subject to the rules of a contract market…" (Emphasis added).

In addition to controlling case law which contradicts Plaintiff's attempt to characterize Shasta's status as a "commodity pool" (supposedly "advised" by Tech) an additional serious difficulty for Plaintiff's attempt to find Section 13(a) liability of Shimer in the context of Tech's alleged violation of Regulation 4.30 lies in the statute which defines the term commodity trading advisor. Moreover the fact that Plaintiff has authority for administering the CEA *does not* mean

that Plaintiff is free to apply any meaning it chooses to the otherwise clear intent of the statutory language chosen by Congress.

The recent case of *New York Currency Research v CFTC* 180 F3d. 83 (2nd Cir. 1999) ("*New York*") is clearly on point and instructive:

> "We deal on this appeal with the interpretation of a statute and rules used by the Commodity Futures Trading Commission (Commission or CFTC) to compel the production of records. (at 85) …We review the CFTC's interpretation and application of the Commodity Exchange Act under the methodology announced by the Supreme Court in *Chevron U.S.A. v. Natural Resources Defense Council, Inc.*, U.S. 837, 842-43, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984). Under *Chevron*, when Congress has " 'directly spoken to the precise question at issue,' " we are obliged to give effect to its " 'unambiguously expressed intent.' "*WLNY-TV, Inc. v. FCC*, 163 F.3d 137, 142 (2d Cir. 1998) (quoting *Chevron*, 467 U.S. at 842-43). This so-called "first step" of *Chevron* may, in some cases, resolve the statutory dispute, in which event the first step is the only step needed for analysis. But if a "'statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.' " Id. (quoting *Chevron*, 467 U.S. at 843). This is the so-called "second step" of *Chevron*. (*New York* at 88)

The Second Circuit further noted in *New York*: at page 88:

> Although *Chevron* dealt only with an agency's interpretation of relevant federal statutes, similar principles apply to judicial review of an agency's interpretation of its own regulations. *Reno v. National Transp. Safety Bd.*, 45 F. 3d 1375, 1379 (9th Cir. 1995); *T.S. Board v. Board of Educ.*, 10 F. 3d 87, 89 (2nd Cir. 1993). Accordingly, the Commission's interpretation of its regulations would be entitled to " 'controlling weight unless it [was] plainly erroneous or inconsistent with the regulation.' " *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512, 114 S.Ct. 2381, 129 L.Ed. 2d 405 (1994) quoting *Udall v. Tallman*, 380 U.S. 1, 16-17, 85 S.Ct 792, 13 L.Ed.2d 616 (1965)); *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414, 65 S.Ct. 1215, 89 L.Ed.1700 (1945).

The Second Circuit in *New York* then noted at page 89:

> The Commission would have us proceed directly to the second step of Chevron, where its interpretations would be given controlling weight, and would have us affirm on this basis. But we decline to do so because here, under the first step, the Commission's interpretation contradicts the plain language of the statute and regulations; where such is the case the "plain language of course controls," *United States v.Lewis*, 93 F.3d 1075, 1080 (2d cir. 1996).

By its clear language that above cited statute anticipates that in order for a CTA relationship to exist between two entities, advice and information with respect to the flow of information (i.e. the advisability of trading) must flow from the "advisor" to the "advisee". There is not a shred of evidence that Tech ever functioned in any advisory capacity whatsoever with respect to "trading in any contract of sale of a commodity for future delivery" by Shasta.

Shasta never intended to engage in the "trading" of futures contracts nor did Shasta ever represent to *anyone* at *anytime* that it intended to or contemplated the "trading in any contract of sale of a commodity for future delivery". For that reason Shasta never had any reason to solicit the "advice" of Tech for that purpose nor did Tech ever have any reason to offer such "advice" to Shasta.

It is true that such advice can take the form of more than just an "exchange of information." Indeed, most CTA relationships are found to exist based upon the fact that the "advice" often provided by the "advisor" takes the from of trading decisions made by the CTA for the benefit of a client who has opened a brokerage account in the name of the client and who, *pursuant to specific written authority* has conferred upon the CTA the specific authorization to trade the client "advisee's" account for the benefit of the "advisee".

The relationship, for example, created between defendant Tech Ltd. and Sterling Trust (Anguilla), by that certain agreement executed between them on March 3, 2003 established a typical CTA relationship between Tech and Sterling whereby Tech was authorized to trade Sterling's GNI account for the benefit of Sterling.[94] The CFTC's own rules further define the term "trading principal" with respect to a commodity trading advisor to be "a principal who participates in making trading decisions for the account of a client." [95]

Clearly the intent of 7 U.S.C. § 1a(6) is that the advice which goes to the heart of the CTA relationship defined by the Statute must be directed to either one who already owns a trading account at a brokerage firm (the typical CTA relationship already described) or one who intends or is at least contemplating opening such an account. "Trading" can only occur from an account opened for that purpose by one who intends to engage in the activity of trading. In the absence of at least that *intention*, there is absolutely no need for the initial exchange of "advice".

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[94] See Declaration Under Penalty of Perjury of Joy McCormack pursuant to 29 U.S.C. § 1746.

[95] See 17 CFR § 4.10(e)(2)(ii)

Shasta never opened a trading account at any brokerage firm nor did Tech ever trade for or on behalf of Shasta. All trading by Tech was effected by brokerage accounts opened by Tech in its own name and traded solely by Tech. Under controlling case law Plaintiff cannot "create" a CTA relationship where one does not exist according to the plain meaning of the Statute.

3. In the absence of a finding that Tech acted as a CTA to Shasta, Shimer's Motion For Summary Judgment should be granted.

Plaintiff has attempted in paragraph 102 of its First Amended Complaint to "construct" a CTA relationship between Tech and Shasta that is not supported by the clear and plain language of 7 U.S.C. § 1a(6). If Tech is not the CTA of Shasta then Tech did not violate Regulation 4.30, 17 CFR § 4.30 at least with respect to Tech's relationship with Shasta. Summary Judgment is, therefore, appropriate with respect to Plaintiff's allegation that Shimer violated Section 13(a) of the Commodity Exchange Act, 7 U.S.C. § 13c(a) by reason of the fact that Shimer aided and abetted Tech's non existent violation of Regulation 4.30 as alleged by Plaintiff in Count V of its First Amended Complaint. Shimer's Motion for Summary Judgment with respect to his alleged violation of 7 U.S.C. § 13c(a) by reason of the fact that Shimer aided and abetted Tech's non existent violation of Regulation 4.30 as alleged by Plaintiff in Count V of its First Amended Complaint should be granted.

C. <u>Shimer Did Not Violate Section 13(a) Of The Commodity Exchange Act By Reason Of The Fact That The Behavior Of Tech As Specifically Alleged By Plaintiff In Paragraph 103 Of Count V of the First Amended Complaint does not support a finding That Tech Acted As A CTA To Shasta.</u>

Plaintiff alleges as follows in Paragraph 103 of its First Amended Complaint:

> "As CTA for the Shasta pool and others, Tech violated Regulation 4.30 by accepting their funds and trading them in its accounts at FCMs under its own name."

Tech's alleged behavior as stated above sounds strangely similar to what Plaintiff alleged previously in its First Amended Complaint when Plaintiff then sought to describe Tech's behavior as a violation of regulations that pertain to commodity pool operators:

> "Tech Traders violated several Commission Regulations, including commingling the property of the "super fund" with the funds of others,

in violation of Regulation 4.20(c).[96]

It is worth pointing out that the behavior quoted just above is stated to be a violation of Commission regulation 4.20(c) (a regulation that applies only to CPO's—not to CTAs). Even more instructive is a comparison of the alleged behavior of Tech to the statutory definition of a CPO found at 7 U.S.C. 1a(5) which defines a commodity pool operator in pertinent part to be:

> "any person …who, … accepts, or receives from others,
> funds,…directly … for the purpose of trading in any commodity
> for future delivery on or subject to the rules of any contract market…"

Simply put, Plaintiff apparently attempts for the purpose of finding Tech in violation of Commission Regulation 4.30 (a regulation that applies only to CTA's) to accuse Tech of behavior that seems more appropriate to support a conclusion that Tech was acting as a unregistered CPO. Paragraph 103 of the First Amended Complaint does not further Plaintiff's contention that Tech acted as a CTA with respect to Shasta because Paragraph 103 puts the cart before the horse.

In the absence of a separate finding that Tech truly acted as a CTA with respect to Shasta, the behavior described by Plaintiff in Count V, Paragraph 103 of the First Amended Complaint does not at all contribute to Plaintiff's circuitous attempt to "prove" by that behavior that Tech violated Commission Regulation 4.30. If the behavior of Tech described by Plaintiff in paragraph 103 does not establish that Tech acted on behalf of Shasta as a CTA but, more appropriately, is a description of the activity of a CPO, a Motion for Summary Judgment is appropriate with respect to Plaintiff's allegation that Shimer violated Section 13(a) of the Act by aiding and abetting Tech's

violation of Regulations 4.30 as alleged in Count V of Plaintiff's First Amended Complaint. Defendant Shimer's Motion For Summary Judgment with respect to Plaintiff's allegation that Shimer violated Section 13(a) of the act by reason of the fact that Shimer aided and abetted Tech's violation of Regulation 4.30 as alleged in Count V of Plaintiff's First Amended Complaint should be granted.

[96] See First Amended Complaint, ¶ 6a;

D. Defendant Shimer Is Entitled To Summary Judgment With Respect To Count V Of Plaintiff's First Amended Complaint Because Tech Never Engaged In Behavior With Respect to Shasta Prohibited By CFTC Regulation 4.30.

1. Violation of Regulation 4.30 by Tech requires a finding that Tech specifically purchased or secured a "commodity interest" for Shasta.

Commission Regulation 4.30, 17 CFR § 4.30 states in pertinent part as follows:

> "No commodity trading advisor may solicit, accept or receive from an existing or prospective client funds, securities or other property in the trading advisor's name…to purchase guarantee or secure *any commodity interest of the client*;…" (Emphasis added)

A primary difficulty for Plaintiff in its desire to establish a violation of regulation 4.30 by Tech for the purpose of assigning liability to Shimer under Section 13 (a) of the CEA for aiding and abetting Tech's violation of Regulation 4.30 is the fact that never at any time during the relationship established between Shasta and Tech did Shasta ever seek or obtain a "commodity interest". It is a fact (that the Plaintiff cannot dispute with any credibility) that Shasta simply agreed to provide funds to help Tech fund its own trading of the Synergy Trading System.

To that end, Shasta wired funds from its bank account to Tech's bank account. Tech agreed (pursuant to the investment agreement executed by and between Shasta and Tech) to allocate a certain part of whatever profits were generated at the end of trading each month to Shasta as a result of trading conducted by Tech. Profits were only generated for the specific account of Tech and/or losses were only incurred by Tech's account when a contract for the purchase of a "commodity interest" (held by Tech) was sold (i.e. when Tech's "long" position "was closed). Similarly profits were only generated for the specific account of Tech and/or losses were only incurred by Tech's account when a contract for the sale of a commodity interest (sold for the account of Tech) was purchased (i.e. when Tech's short position was closed).

At no time did the Investment Agreement executed between Shasta and Tech ever vest, according to its term, a "commodity interest" in Shasta nor did Shasta ever seek to obtain such a commodity interest from Tech nor did Tech ever confer a "commodity interest" upon Shasta. Nor is it possible for the Plaintiff to credibly claim otherwise.[97]

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[97] See *New York Currency Research v CFTC* 180 F3d. 83 (2nd Cir. 1999) and the cases cited therein for the proposition that a Federal Agency is confined to the clear and plain language of its controlling statute and its own

It was impossible for Tech to confer a "commodity interest" upon Shasta because all funds were traded only in the name of Tech and, as the account owner, only Tech was in a position to buy or sell a commodity interest. Until Shasta opened a commodity trading account of its own, in its own name, it was virtually impossible for Shasta to obtain a obtain a "commodity interest" as a result of the mere contractual obligation on the part of Tech to share profits from trading with Shasta.

2. In the absence of a finding that Tech ever received funds from Shasta in Tech's name to specifically purchase a "commodity interest" for Shasta, Summary Judgment for defendant Shimer is appropriate and should be granted.

By virtue of the fact that Tech did not, at any time violate Commission Regulation 4.30 by receiving from Shasta funds to purchase or secure any commodity interest of Shasta, for Shasta or that belonged to Shasta, a Motion for Summary Judgment is appropriate with respect to Plaintiff's allegation that Shimer violated Section 13(a) of the Act by aiding and abetting Tech's violation of Regulations 4.30 as alleged in Count V of Plaintiff's First Amended Complaint. Shimer's Motion For Summary Judgment with respect to Plaintiff's allegation that Shimer violated Section 13(a) of the Act by reason of the fact that Shimer aided and abetted Tech's violation of Regulation 4.30 as alleged in Count V of Plaintiff's First Amended Complaint should be granted.

E. Shimer Is Entitled To Summary Judgment With Respect To Count V Of Plaintiff's First Amended Complaint Because Plaintiff Has Absolutely No Evidence That Satisfies The Legal requirements Necessary For A Finding That Shimer Specifically "Aided And Abetted" Tech's Alleged violation of Regulation 4.30.

1. Case law imposes a required standard for establishing proving "aiding and abetting" that Plaintiff CFTC cannot possibly meet.

Section 13(a) of the Commodity Exchange Act, 7 U.S.C. § 13c(a) states in pertinent part as follows:

> "Any person who commits, or who willfully aids, abets, …a violation of any of the provision of this chapter, or any of the

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regulations. The "second step" of Chevron is only permissible if a statute or regulation "is silent or ambiguous with respect to the specific issue…". (citing *Chevron* 467 U.S. at 843).

rules; regulations…or who willfully causes an act to be done
or omitted which if directly performed or omitted by him or
another would be a violation of the provisions of this chapter…
may be held responsible for such violation as a principal."

The Third Circuit Court of Appeals in *Nicholas v Saul Stone & Co*. 224 F.3d 179 (3d Cir. 2000) citing the Seventh circuit case of *Damato v Hermanson*, 153 F.3d 464, (7th Cir. 1998) offers the following insight into the standard to be applied before a finding of "aiding and abetting" can be established with respect to a defendant under the Commodity Exchange Act:

> "The Damato court analyzed the elements of aider and abetter liability under subsection 22(a)(1) as being identical with those contemplated by the federal criminal aider and abetter statute, 18 U.S.C. S 2. See 153 F.3d at 473. It therefore concluded that "*in order to state . . . a claim against [a defendant] . . . plaintiffs must allege that [the defendant] (1) had knowledge of the principal's .. . intent to commit a violation of the Act; (2) had the intent to further that violation; and (3) committed some act in furtherance of the principal's objective."* Id. The Seventh Circuit thus recognized that to "aide and abet" one must (a) have knowledge of the principal's intended violation of the statute, and (b) have the intent to promote that principal's violation. This interpretation is consistent with both the traditional understanding of what is meant by "aiding and abetting" and with the language of subsection 22(a)(1), which contemplates liability for one "who willfully aids [and] abets . .. the commission of a violation" of the CEA. (Emphasis added). We agree with the Seventh Circuit that aiding and abetting in the context of the CEA is congruent with aiding and abetting as defined by 18 U.S.C. S 2." *Nicholas* at page 189.

Moreover, mere recklessness or alleging that a defendant "knew or should have known" is insufficient according to the court in *Nicholas*:

> "In essence, appellants have alleged at most, that the FCMs acted recklessly, and that they knew or should have known of the violations by Kohli, Ramchandran, and Sigma of the CEA. But these allegations are a far cry from an allegation that the FCMs not only had knowledge of the intent of Kohli and the others to violate the CEA, but, as the Seventh Circuit put it in Damato, "the intent to further that violation." 153 F.3d at 473." See *Nicholas* at Page 190.

2. Facts that Plaintiff CFTC cannot deny preclude, as a matter of law, a finding that Shimer aided and abetted Tech's alleged violation of Regulation 4.30, 17 CFR § 4.30.

That Plaintiff should seek to hold Shimer liable under the provisions of Section 13(a) of the CEA is a departure from even the semblance of reality. The record in the present matter not only suggests but confirms beyond a shadow of a doubt that at all times Shimer took his responsibilities (and the responsibility of everyone else) seriously regarding the necessity of complying with all applicable rules and regulations of Plaintiff.

Plaintiff cannot dispute with any credibility that in the fall of 2001, Shimer submitted a multi page memorandum to a legal colleague and received confirmation several weeks later from his legal colleague that the client's legal division basically *agreed with Shimer's previous conclusions with respect to the CPO/CTA status of both Shasta or Equity that neither entity met the definition of a CPO or CTA*.

Nor can Plaintiff dispute with any credibility that Shimer sought out reputable and knowledgeable outside securities legal counsel when the issue of Shasta's registration status was once again brought into question in the fall of 2003. The record clearly shows that Shimer sent to Aronow (a partner in the law firm of Arnold & Porter who had previously served as Director of Plaintiff's Enforcement Division from 1995 to 1999) a four page cover letter dated Friday October 24, 2003 in which Shimer described *in clear detail the entire contractual relationship that existed between his client Shasta and Tech Traders, Inc*.

Moreover, Shimer specifically spent time in his cover letter to Aronow highlighting the fact that the relationship between Shasta and Tech was not a traditional one in which a separate account had been established for the trading by Tech of Shasta's funds. *Shimer clearly disclosed to Aronow in his cover letter the fact that all of Shasta's funds were co-mingled with both Tech's funds and also commingled with the funds of other Tech clients in a "super fund" trading account established in Tech's name only*.

Shimer made it *very clear* to Aronow that Shasta's funds were being traded by Tech from an account in Tech's name only. Shimer *never received any indication written, verbal or otherwise from Aronow* (*the previous head of Plaintiff's own Enforcement Division*) that this particular investment arrangement between his client Shasta and Tech a) might itself be a violation of the CFTC's Regulation 4.30, 17 C.F.R. § 4.30 by Tech or b) that the mere act of

drafting the investment agreement that existed between his client Shasta and Tech which allowed for a co-mingling of funds received from Shasta with other Tech client funds or funds belonging to Tech might possibly subject Shimer personally to alleged liability under Section 13(a) of the Commodity Exchange Act, 7 U.S.C. § 13c(a).[98]

Furthermore, it is also highly significant with respect to the issue of "scienter" and what Shimer either "knew" or "intended" that Aronow and Lee at Arnold & Porter *never* advised Shimer, or defendant Firth, or Shasta or Shasta's manager Equity that it might be advisable to cease receiving funds from accredited investors until any registration question with respect to Shasta, Equity or Tech was resolved!

In light of all of the above stated facts which are true (and which cannot be disputed with any credibility by the CFTC) to view Plaintiff's allegation that Shimer should be held liable under Section 13(a) of the Commodity Exchange Act by reason of the fact he is alleged to have "aided and abetted" Tech's violation of Commission Regulation 4.30 by "drafting an investment agreement between Shasta and Tech Traders that provides that pool funds will be held in the name of Tech Traders"[99] or because Shimr drafted the PPM that also sets out that funds will be held in the name of the trading company"[100] is to be reminded once again of Judge Cardamone's previous observation about this same Federal agency:

> "Certain aspects of this case have an Alice in Wonderland quality about them"[101]

3. Summary Judgment for defendant Shimer is appropriate and should be granted.

The CFTC has absolutely no credible facts to support its allegation that Shimer had any knowledge of Tech's purported violation of Regulation 4.30 or that Shimer ever acted with the intention to "further" that purported violation. It would, therefore, be virtually impossible for any reasonably objective person to conclude that Shimer "aided and abetted" Tech's violation of Regulation 4.30 solely because he drafted either the Shasta investment agreement with Tech or Shasta's PPM. A Motion For Summary Judgment with respect to Plaintiff's allegation that

[98] See First Amended Complaint, Count V, ¶ 104.
[99] See, again, First Amended Complaint, Count V, ¶ 104
[100] See one more time: First Amended Complaint, Count V, ¶ 104
[101] *New York Currency Research* v. CFTC 180 F.3d 83 (2nd Cir. 1999) at 85.

Shimer aided and abetted defendant Tech's violation of Regulation 4.30 is appropriate. Shimer's motion for Summary Judgment with respect to Plaintiff's allegation that Shimer violated Section 13(a) of the Commodity Exchange Act by reason of the fact that he "aided and abetted" defendant Tech's alleged violation of Regulation 4.30 should be granted.

CONCLUSION

For the reasons set forth in this Brief, the controlling case law specifically cited by Plaintiff and the clear unavoidable fact that Plaintiff cannot credibly contradict the plethora of facts now offered to the Court (such facts being all times readily and easily available and now clearly in Plaintiff's possession) Defendant Shimer respectfully requests that this Court grant Defendant the relief requested in the accompanying Proposed Motions.

Date: April 13, 2005

s/ Robert W. Shimer

Robert W. Shimer