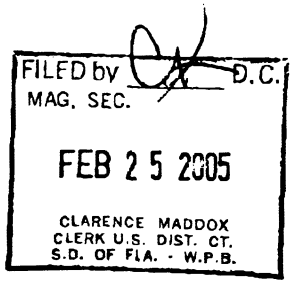
UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

Case No.05-80002-Civ-Hurley/Hopkins

COMMODITY FUTURES
TRADING COMMISSION,



Plaintiffs,

vs.

UNITED INVESTORS GROUP, INC.;
GREG P. ALLOTTA; JAY M. LEVY;
PAUL F. PLUNKETT; ANDREW D.
ROSS; AND MICHAEL H. SAVITSKY III,

Defendants,

GREG ALLOTTA ENTERPRISES, INC. and
MICHAEL SAVITSKY, INC.,

Relief Defendants.

_____/

REPORT AND RECOMMENDATION AS TO PLAINTIFF'S MOTION FOR AN ORDER TO SHOW CAUSE REGARDING PRELIMINARY INJUNCTION (DE 4)

THIS CAUSE has come before this Court upon an Order Granting Motion to Show Cause Regarding Plaintiff's Motion for Preliminary Injunction which referred the matter to Magistrate Judge for a Report and Recommendation. (DE 12). For the reasons that follow, this Court **RECOMMENDS** that the District

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Court **GRANT** the Plaintiff's Motion for Preliminary Injunction as to each of the Defendants and Relief Defendants.

BACKGROUND

1. On January 11, 2005, the Plaintiff filed an Ex Parte Motion for a Statutory Restraining Order to Freeze Assets, Preserve Books and Records, and for an Order to Show Cause Regarding Preliminary Injunction, wherein the Plaintiff claimed that the Defendants had committed violations of the anti-fraud provisions of Section 4c(b) of the Commodities Exchange Act (CEA), 7 U.S.C. § 6c(b) and Regulation 33.10(a) and (c) of the Commission Regulations, 17 C.F.R. § 33.10(a) and (c). (DE 6).

2. On January 3, 2005, the District Court granted Plaintiff's Motion for the Ex Parte Temporary Restraining Order and referred the Plaintiff's Motion for a Preliminary Injunction to the undersigned for a Report and Recommendation. (DE 12). This Court set the matter for an evidentiary hearing on January 17, 2005. (DE 12). By Notice of Hearing this date was changed to January 18, 2005. (DE 19). On January 18, 2005 the Court granted an agreed motion to reset the hearing, and the hearing was reset to January 31, 2005. (DE 22).

THE EVIDENTIARY HEARING

This Court conducted an evidentiary hearing on the Plaintiff's Motion for Preliminary Injunction on January 31, 2005, wherein the Plaintiff was represented by Charles D. Marvine, Esq. and Rachel A. Hayes, Esq., and all Defendants were represented by Larry Bonner, Esq. and Francisco Sanchez, Esq.

At the commencement of the hearing, the parties gave their respective opening statements. As an initial matter, Plaintiff stated that Defendants have yet to supply the list of assets as required by the January 3, 2005 order granting the restraining order. (DE 6). The Plaintiff noted that unlike the typical preliminary injunction, a statutory injunction under the CEA only requires the Plaintiff to show that there has been a violation of the CEA, and that there is likelihood of continuing violation if the injunction is not granted. Plaintiff asserted that Defendants violated the CEA by "cold calling" customers and making various misrepresentations regarding profit and loss potential in order to induce customers to purchase options. The Plaintiff noted that the Memorandum in Support of the Motion for Ex Parte Restraining Order and Order to Show Cause is annexed with 16 customer declarations stating that Defendants guaranteed profits, assured customers that they were protected against losses, and utilized other high pressure tactics. (DE 6). The Plaintiff pointed out that the Defendants have only submitted

"self-serving" declarations from Defendants asserting that the customers are lying. (DE 29). The Plaintiff noted that the customers came from all over the United States and Canada, and that the customers approached the CFTC - the CFTC did not seek out the complaining customers.

Referring to the Defendants memorandum in opposition of the motion, the Plaintiff noted that while Defendants assert that UIG is out of business, Defendants offer no proof of this. Plaintiff additionally noted that UIG was still in business when Defendants were served on January 4. Plaintiff further asserted that the case relied upon by the Defendants in their opposition to the asset freeze, *Grupo Mexicano de Desarrollo v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999), is not applicable to the current case as the current case is statutory and equitable, distinguishable from the action at law in *Grupo*. Plaintiff asserted that *SEC v. Comcoa Ltd.*, 887 F.Supp 1521 (S.D.Fla. 1995) and *United States ex rel. Rahman v. Oncology Assocs., P.C.*, 198 F.3d 489, 492 (4th Cir. 1999) provide a basis for freezing the Defendants' assets. Plaintiff noted that Defendants, through their business, took in approximately $6 million through June 2004, $4.2 million of which went directly to the Defendants. Plaintiff further noted that in response to the court order, Defendants have only accounted for $100,000 of these funds. (DE 12). Over Defendants' objection, the court admitted the declarations attached to

the Plaintiff's memorandum into evidence. (DE 6, ex. 1-3).

In response, the Defendants contended that the Plaintiff filed the current case in response to Plaintiff's dissatisfaction with the progress of another case before this Court against the same Defendants, *CFTC v. First Am. Inv. Servs., Inc., et al,* Civil Action No. 04-60744 (S.D. Fla. Filed June 7, 2004). Defendant noted that many of the declarations entered by the Plaintiff were executed by the same customers who provided declarations for the *First America* case. Defendants pointed to the breadth of the restraining order freezing Defendants assets, asserting that the order was so expansive that everything the Defendants ever had or will have is frozen, including their "first communion money." Defendants additionally asserted that an order freezing after-acquired asserts is equivalent to an order enjoining the Defendants from working. Defendants contended that the Plaintiffs need stronger allegations to support their motion, and that there must be traceability between the frozen assets and the alleged violations. Defendants noted that the declarations filed by each Defendant strongly contests any wrongdoing or that any misrepresentations were made. Defendants further asserted that under *Grupo Mexicano*, the District Court does not have the authority to freeze the Defendants' assets.

ANALYSIS

In its Motion for Preliminary Injunction, the Plaintiff alleges that the Defendants are liable for violations of the Commodities Exchange Act (CEA), 7 U.S.C. §§ 1 *et seq.* (DE 6).

For the reasons that follow, this Court concludes that the Plaintiff has met its burden of proving all the elements required to obtain a Preliminary Injunction under the CEA. This Court will first address the burden Plaintiff must meet to obtain a Preliminary Injunction based upon the activities of the UIG Associated Persons (AP's). This Court will then address the Plaintiff's controlling persons claims. Finally, this Court will address whether authority lies with this Court to freeze the Defendant's assets.

I. PLAINTIFF'S MOTION FOR PRELIMINARY INJUNCTION

Plaintiff asserts that several of the individual Defendants, acting as Associated Persons (AP's) for UIG, misrepresented the loss and profit potential involved with purchasing commodity options, inducing customers to purchase commodity options. (DE 6). In order to obtain a Preliminary Injunction, the Plaintiff must demonstrate a prima facie case that a violation has occurred and that there is a reasonable likelihood of a future violation. *SEC v. Unique Fin. Concepts, Inc.*, 196 F.3d 1195, 1199 n.2

(11th Cir. 1999); *CFTC v. Hunt*, 591 F.2d 1211,1220 (7th Cir. 1979). Unlike that traditional preliminary injunction, to obtain a statutory injunction the Plaintiff need not prove irreparable harm or inadequacy of other remedies. *CFTC v. Muller*, 570 F.2d 1296, 1300 (5th Cir. 1978).

A. Prima Facie Violation

Section 4c(b), 7 U.S.C. § 6c(b), provides that: "No person shall...enter into or confirm the execution of any transaction involving any...option contrary to any...regulation of the Commission." Regulation 33.10, 17 C.F.R. § 33.10, provides that:

> It shall be unlawful for any person directly or indirectly
> (a) to cheat or defraud or attempt to cheat or defraud any other person;
> (b) To make or cause to be made to any othe person any false report or statement therof or cause to be entered for any person any false record thereof;
> (c) to deceive or attempt to deceive any other person by any means whatsoever
> in or in connection with an offer to enter into, the entry into, the confirmation of the execution or, or the maintenance of, any commodity option transaction.

"In order to establish liability for fraud, CFTC had the burden of proving three elements: (1) the making of a misrepresentation, misleading statement, or a deceptive omission; (2) scienter; and (3) materiality." *CFTC v. R.J. Fitzgerald & Co., Inc.*, 310 F.3d 1321, 1328 (11th Cir. 2002). Proving a prima facie case of illegality is sufficient

to meet the first prong necessary to obtain a Preliminary Injunction under the CEA. *Muller*, 570 F.2d at 1300.

1. Misrepresentation, Misleading Statement or Deceptive Omission

In determining whether a misrepresentation has been made, Courts look at the "overall message," and how that message would be interpreted by the average customer. *See R.J. Fitzgerald*, 310 F.3d at 1329. Additionally, the Eleventh Circuit in *R.J. Fitzgerald* held that where the overall message is misleading, boilerplate risk disclosures may not automatically preclude liability under the CEA. *Id.* (recognizing that "the underlying remedial purpose of the Act [is] protecting the individual investor from being misled or deceived in the highly risky arena of commodities investment").

Courts have found a number of specific types of statements or omissions to be inherently fraudulent. Guarantees of profits or against losses are inherently fraudulent. *See id.* (finding that promises of 200 or 300 percent profit were fraudulent); *CFTC v. Standard Forex Inc.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,063 at 41,462 (E.D.N.Y. Aug. 9, 1993).

In its memorandum supporting the motion for preliminary injunction, Plaintiff enumerates more than a dozen examples of statements made to customers assuring them that vast profits were in their future, and that the risk of loss was minimal. (DE 6). For example:

* Savitsky told a customer that, in only two months, he should make at least $14,000 on a $3,000 investment. (DE 6, ex. 3, Johnson Decl. ¶ 3).

* Levy told a customer that an additional $34.000 investment would generate over $100,000 in only one week. (DE 6, ex. 3, Rivera Decl. ¶ 8).

* Allotta guaranteed one customer that, in only a few days, he would make a 100% return on a $25,000 investment in heating oil options. (DE 6, ex. 3, Hall Decl. ¶ 7).

* Levy and Allotta told customers that it was impossible to lose money because they were going to make money whether the market moved up or down. (DE 6, ex. 3, Anderson Decl. ¶ 6; Beaumont Decl. ¶10; Hall Decl. ¶ 7; Hartig Decl. ¶ 4; Johnson Decl. ¶ 5; Manders Decl. ¶ 5; Pighin Decl. ¶ 8; Rivera Decl. ¶9).

* Savitsky, Allotta, Shapiro, Atz and Bobba told customers that stop loss orders would limit their losses. (DE 6, ex. 3, Andrade Decl. ¶¶ 6, 11; Landt Decl. ¶¶ 6, 11; Johnson Decl. ¶ 3; Pighin Decl. ¶4).

These statements were made despite the fact that more than 95% of UIG's customers were losing their investments. (DE 6, ex. 1, Dingman Decl. ¶ 13). Omitting mention of the enormous losses incurred by UIG customers while discussing

potential for great profits constitutes a fraudulent act. *See CFTC v. Commonwealth,* 874 F. Supp. 1345, 1354 (S.D. Fla. 1994); *Standard Forex,* Comm. Fut. L. Rep. (CCH) ¶ 26,063 at ¶ 41,462 ("in light of the hemorraging losses continually incurred by customers of Standard Forex, it is clear that the risk involved was enormous and that any representations of assured profits were false and misleading").

Courts have also held that claims that customers may capitalize on seasonal factors and other publicly known events are fraudulent as this information is already factored into the price of the commodity. *R.J. Fitzgerald,* 310 F.3d 1330 (holding that "this Court and the CFTC have previously condemned attempts to attract customers by: (1) linking profit expectations on commodities options to known and expected weather events, seasonal trends, and historical highs..."); *Bishop v. First Investors Group for the Palm Beaches, Inc.,* Comm. Fut. L. Rep. (CCH) ¶27,004 (1997); 1997 CFTC LEXIS 79 at * 20 (finding that failing to "disclose that a seasonal increase in the demand for heating oil would not necessarily result in the increased value of a heating oil option, because the market had already factored seasonal demand into the price of an option" was a misleading half-truth and a violation of the CEA).

Customer declarations attached to the Plaintiff's Memorandum of Points and Authorities (DE 6) cite numerous examples of brokers advising clients that they may profit as a result of seasonal trends and other publicly known information. Examples

of such statements are as follows:

* Bobba recommended that a customer purchase unleaded gas options, citing the coming summer, the war in Iraq and the general supply and demand for unleaded gas as reasons why such an investment would be profitable at that time. (DE 6, ex. 3, Anderson Decl. ¶ 4).

* Shapiro told a customer that he should purchase heating oil options because heating oil prices would rise "in response to planned production cuts by OPEC and increased consumer demand for heating oil due to this year's harsh winter in the United States." (DE 6, ex. 3, Andrade Decl. ¶ 4).

*Allotta advised a customer that crude oil prices would be increasing "due to a recent pipeline sabotage in Kuwait." (DE 6, ex. 3, Andrade Decl. ¶ 10).

* Bobba advised a customer that "the value of unleaded gasoline options was set to increase in the near term because of the war in Iraq, the threat of terrorism, and the arrival of summer in the United States." (DE 6, ex. 3, Beaumont Decl. ¶ 4).

* Levy advised a customer that the value of the Euro had potential to increase rapidly because "the dollar had to be devalued to combat both

U.S. unemployment and the U.S. trade deficit prior to the November 2004 presidential election." (DE 6, ex. 3, Beaumont Decl. ¶ 10)

* Allotta recommended that a customer invest in crude oil options because "due to a shortage of oil in the US, the war in Iraq, and the beginning of the heating season [the customer] could earn between 30-40% on [his] investment." (DE 6, ex. 3, DiLollo Decl. ¶ 4).

The above are only a few of the numerous statements made to customers by UIG APs. (DE 6, ex. 3). Each of the above statements projects the ability to capitalize on seasonal trends or publicly know information, such as the wars in Iraq and Kuwait. Clearly these statements are inherently fraudulent under the Eleventh Circuit's holding in *R.J. Fitzgerald.*

Defendants rebut more than a dozen customer declarations with their own self-serving declarations refuting the customer allegations. (DE 29). Defendants further support their position by referring to tape recorded conversations they state demonstrate that customers were advised that they could lose their entire investment and that profits were not guaranteed. (DE 29). However, just as boilerplate risk language will not serve to eliminate liability when the overall message was misleading, a tape recorded conversation may not eliminate liability when a number of

discussions gave an altogether different message regarding profits and risk. *J.C.C., Inc. v. CFTC*, 63 F.3d 1557, 1570 (11th Cir. 1995) (holding that a tape-recorded compliance system is insufficient to relieve the defendant of liability because "[o]ne 'cannot use the customer agreement as a contractual shield against valid federal regulation and liability for violation of such regulation, or as an 'advance exoneration of contemplated fraudulent conduct'"").

2. Scienter

Scienter "refers to a mental state embracing an intent to deceive, manipulate, or defraud." *CFTC v. Rosenberg,* 85 F. Supp.2d 424, 448 (D. N.J. 2000). Recklessness is sufficient to fulfill the requirement of scienter. *Drexel Burnham Lambert, Inc. v. CFTC,* 850 F.2d 742, 748 (D.C. Cir. 1988) (citing the 5th Circuit's holding defining recklessness as an action "that departs so far from the standards of ordinary care that it is very difficult to believe the [actor] was not aware of what he was doing").

In *R.J. Fitzgerald*, the Eleventh Circuit found that the element of scienter had been met because the Defendant had acted recklessly as both the CFTC and the Eleventh Circuit had "previously condemned attempts to attract customers by: (1) linking profit expectations on commodities options to known and expected weather events, seasonal trends, and historical highs; (2) suggesting that the commodities market can be correctly timed to generate large profits; and (3) substantially inflating

option profit expectations while downplaying risk of loss." *R.J. Fitzgerald*, 310 F.3d at 1330.

Similarly, the Defendants in this case are or have been registered with the Commission, (DE 6, ex. 1, Dinghman Decl. ¶¶ 6-10) and as such are charged with the knowledge that such activities as guaranteeing profits and protection against risk, linking profits to weather and seasonal trends, and the necessity to begin trading immediately or miss the opportunity to maximize profits are inherently fraudulent. The element of scienter is reinforced by Plaintiff's assertion that, while Defendants continued to downplay the risk of investment, over 98% of UIG customers who opened accounts through UIG collectively lost approximately $6,133,592 between August 4, 2003 and June 30, 2004.[1]

3. Materiality

Throughout their declarations, Defendants repeat the statement that the customers approved the relevant trade. However, Defendant apparently fails to grasp the point that *why* the customer approved the trade is as important as *whether* the customer approved the trade. Even if an individual authorizes a trade, if that decision was based upon misleading information or omission, the authorization can hardly be considered knowing and intelligent. In *R.J. Fitzgerald*, the Eleventh Circuit notes that

[1] Despite the enormous losses by UIG customers, UIG generated approximately $4,252,628 in commissions and fees from customers during this time.(DE 6).

"[t]he omission of highly material information is pernicious because it strikes at the very core of individual autonomy." *R.J. Fitzgerald,* 310 F.3d at 1333 ("It is too obvious for debate that a reasonable listener's choice-making process would be substantially affected by emphatic statements on profit making potential....").

The Defendants misled customers on such topics as potential profits, potential risk of loss, and the likelihood that profits will be reaped based upon certain events. The Defendants additionally omitted such important information as the extraordinary losing record of UIG customers. Such information, or lack thereof, would without question affect a customer's decision regarding whether to place a trade. *In re JCC,* Comm. Fut. L. Rep. ¶ 26,080 at 41,576 n.23 (CFTC May,1994), *aff'd* 63 F.3d 1557 (11th Cir. 1995) ("When the language of a solicitation obscures the important distinction between the possibility of substantial profit and the probability that it will be earned, it is likely to be materially misleading to customers").

Furthermore, an extraordinarily high losing record of a firm would obviously be material to a customer's decision whether or not to place a trade with that firm. *CFTC v. Commonwealth Financial Group, Inc.,* 874 F.Supp 1345, 1354 (S.D. Fl. 1994) ("Misrepresentations regarding the trading record and experience of a firm or broker are fraudulent because past success and experience are material factors which a reasonable investor would consider when deciding to invest commodity options

through that firm or broker").

Because Plaintiffs have demonstrated that Defendants, acting with sceinter, made material misrepresentations or omissions to customers. this Court finds that Plaintiff has adequately demonstrated a prima facie case that Defendants have violated the CEA.

B. Likelihood that Violations will Reoccur if Activity is not Enjoined

"Once a violation is demonstrated, the moving party need show only that there is some reasonable likelihood of future violations." *Hunt,* 591 F.2d at 1220. "The likelihood of future violations can be inferred from the Defendants' past illegal conduct." *CFTC v. MAD Financial, Inc.,* Comm. Fut. L. Rep. ¶ 28,980 (S.D.Fla. 2002), 2002 WL 1972063 at *7; *Hunt,* 591 F.2d at 1220 (citing *SEC v. Management Dynamics, Inc.,* 515 F.2d 801, 807 (2nd Cir. 1975).

This Court notes that the current case is not the first lawsuit against these Defendants. There is, in fact, another lawsuit currently before this court against these individual Defendants. *See CFTC v. First Am. Inv. Servs., Inc., et al,* Civil Action No. 04-60744 (S.D. Fla. Filed June 7, 2004). Defendants assert that the current case was brought merely out of dissatisfaction by the Plaintiff at the progress in the *First America* case. This court finds it troubling, however, that the Defendants have developed a pattern of misleading customers regarding the profit and loss potential of

purchasing options, developing an extraordinarily high loss rate, and then closing up shop. Defendants themselves assert that UIG is closed for business (although Plaintiff notes that UIG was still operating when Defendants were served, less than four weeks prior to the hearing). The same Defendants asserted that a preliminary injunction in *First America* was unnecessary on the basis that that firm had gone out of business and wound up operations. *Id.*

Furthermore, according to the declaration of Lacey Dingman (DE 6, ex. 1), the individual defendants have been involved in the following disciplinary proceedings:

> * Four of the previous firms at which Allotta was employed by were disciplined for sales practice fraud by NFA's Business Conduct Committee (BCC) and a fifth firm is currently subject to a Commission complaint. Alotta was specifically named in a 2002 NFA BCC complaint, and as a result of that action, Allotta was fined $12,000 and subject to enhanced supervisory procedures for one year. Allotta is also named as a defendant in *CFTC v. First America.*
>
> * Three of the firms at which Levy was previously employed have been barred from NFA membership. A fourth firm is currently subject to a

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>
> * Three of the firms at which Levy was previously employed have been barred from NFA membership. A fourth firm is currently subject to a complaint from the Commission. All of these incidents involved sales practice violations. Furthermore, Levy has individually been subject to

two NFA BCC complaints, resulting in a $20,000 fine and a requirement that he tape record customer sales solicitations for three months.

* One previous firm in which Plunkett has been registered as an AP and listed as a principal has been subject to regulatory action filed by the Commission.

* Two firms previously employing Ross have been subject to regulatory action with allegations of sales practice fraud.

* Two firms formerly employing Savitsky have been subject to regulatory actions for sales practice fraud. Savitsky has been specifically named in two complaints, an NFA BCC complaint, and the *CFTC v. First America* action.

"When the violation has been founded on systematic wrongdoing, rather than an isolated occurrence, a court should be more willing to enjoin future misconduct." *Hunt,* 591 F.2d at 1220. This Court is reluctant to permit the Defendant the opportunity to continue to mislead customers and induce them to enter into trades in violation of the CEA.

II. Ross and Plunkett's Liability as Controlling Persons

Plaintiff asserts that Relief Defendants Ross and Plunkett are liable for

violations of Section 13(b) of the CEA, 7 U.S.C. § 13c(b). (DE 6). "A fundamental purpose of section 13(b) is to allow the Commission to reach behind a corporate entity to the controlling individuals of the corporation and to impose liability for violations of the Act directly on such individuals as well as on the corporation itself." *In re JCC,* Comm. Fut. L. Rep. ¶ 26,080 at 41,578 (finding principals of the company liable because they were officers of the corporation who were involved in monitoring sales activities).

In order to establish controlling person liability, the following elements must be proven: "(1) an underlying violation; (2) control by the defendant, direct or indirect, over the person or entity that committed the underlying violation; (3) either (a) absence of good faith of the controlling person *or* (b) knowing inducement directly or indirectly, by the controlling person." *Standard Forex,* Comm. Fut. L. Rep. (CCH) ¶ 26,063; 1993 U.S. Dist. LEXIS 19909 at *38. The underlying violation element is satisfied, as discussed above in Section IA, *supra*. The remaining elements are addressed below.

The CEA defines a controlling person as "[a]ny person who, directly or indirectly, controls any person who has violated any provision of the Act [if that controlling person] did not act in good faith or knowingly induced, directly or indirectly, the act or acts constituting the violation." 7 U.S.C. § 13c(b).

In *In re JCC*, later affirmed by the Eleventh Circuit, the Commission adequately demonstrated that the defendants were controlling persons with constructive knowledge of the violative activities. *In re JCC*, Comm. Fut. L. Rep. ¶ 26,080. The defendants in *JCC* were involved with hiring and firing, salary, training and monitoring sales solicitations. *In re JCC,* Comm. Fut. L. Rep. ¶ 26,080. As of October, 2004, Paul Plunkett was listed as UIG's Chief Executive Officer. (DE 6, ex. 1, Dingman Decl. ¶5). An NFA audit revealed that Ross and Plunkett were UIG principals, although Ross withdrew as principal in May 2004. Plunkett also withdrew as principal in March 2004, but relisted as principal in May, 2004. (DE 6, ex. 2, Zickus Decl. ¶ 4)

Plunkett was responsible for training UIG's APs. Ross acknowledged that he was the principal responsible for supervising UIG's daily operations, including hiring and firing APs, monitoring the APs work (including sales solicitations), and any disciplinary actions taken. (DE 6, ex. 2, Zickus Decl. ¶ 4). Ross routinely walked around the room used by UIG APs to solicit customers, observing the AP's solicitation activities. (DE 6, ex. 2, Zickus Decl. ¶ 4) After Ross withdrew as principal, Plunkett became responsible for UIG's daily supervisory duties, including monitoring the work of APs (including sales solicitations) and responsibilities for disciplinary actions and customer complaints. (DE 6, ex. 2, Zickus Decl. ¶ 5). During the time they were UIG

principals, both Ross and Plunkett had controlling influence over UIG operations. (DE 6, ex. 2, Zickus Decl. ¶ 6).

Defendants fail to address the claims against Ross and Plunkett as controlling persons in their Memorandum in Opposition to Plaintiff's Motion for Preliminary Injunction. (DE 29). At the evidentiary hearing, Defendants asserted that there was no suggestion that Ross or Plunkett acted in bad faith, and that Plunkett merely trained brokers to pass the Series III exam. The standard for liability as a controlling person, however, does not require bad faith, but either bad faith *or* knowing inducement. *R.J. Fitzgerald*, 310 F.3d at 1334.

The Eleventh Circuit has held that to satisfy the factor of knowing inducement, "CFTC must show that the controlling person had actual or constructive knowledge of the core activities that make up the violation at issue and allowed them to continue. *Id.* Constructive knowledge may be found if the Plaintiff demonstrates that the Defendant "lack[ed] actual knowledge only because he consciously avoid[ed] it." *In re JCC,* 63 F.3d 1569 (internal citation omitted).

Ross and Plunkett both qualify as controlling persons. Both were involved with training the sales force, as well as with any necessary disciplinary action. Furthermore, even if Ross and Plunkett did not have actual knowledge of the violations, this Court finds that they had constructive knowledge. Ross and Plunkett's

involvement with training salespeople and monitoring sales activity would surely be sufficient to meet the requirement of constructive knowledge. However, in addition to these duties, Ross and Plunkett were exposed to customer complaints, and responsible for disciplinary action. In light of the knowledge that they would have received from customers, the only way Ross or Plunkett could *not* have knowledge of the activities of the sales staff is if they consciously ignored it.

Because of their role in training and monitoring the sales staff, and because of their actual or constructive knowledge of the CEA violations, both Ross and Plunkett are liable as "controlling persons" for the violations of the CEA committed by UIG and its APs.

III. This Court has the Authority to Freeze Defendants' Assets

Defendants assert that this Court does not have the authority to freeze the Defendants' assets. Defendants additionally assert that the Plaintiff has not provided an adequate basis to freeze the Defendants' assets. This Court disagrees with both of these assertions.

"A request for equitable relief invokes the district court's inherent equitable powers to order preliminary relief, including an asset freeze, in order to assure the availability of permanent relief." *Levi Strauss & Co. v. Sunrise International Trading Inc.*, 51 F.3d 982,987 (11th Cir. 1995); *MAD Financial,* Comm. Fut. L. Rep. ¶ 28,980,

2002 WL 1972063 at *7 ("[t]here is substantial likelihood that, absent the continuation of the asset freeze, Defendants will conceal, dissipate or otherwise divert its assets, thereby defeating the possibility of effective final relief in the form of equitable monetary relief for investors").

Despite Defendant's contention to the contrary, the Supreme Court's decision in *Grupo Mexicano de Desarrollo v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999), does not apply in this case. In *Grupo*, the Supreme Court held that district courts do not have the power to freeze a defendant's assets in an action for money damages when no lien or equitable interest is claimed in those assets. *Id.* The Court found that "[b]ecause such a remedy was historically unavailable from a court of equity...the District Court had no authority to issue a preliminary injunction preventing petitioners from disposing of their assets pending adjudication of respondents' contract claim for money damages. *Id.* at 333.

In the current case, however, the Plaintiff is not merely seeking to freeze the assets merely to ensure the funds are available to satisfy an award of money damages, but Plaintiff seeks equitable remedies, disgorgement and restitution. (DE 1).

Since the *Grupo* decision, several federal courts have concluded that the *Grupo* decision is limited to cases where a plaintiff has no lien or equitable interest in a defendant's assets. *See United States ex rel. Rahman v. Oncology Assocs., P.C.*, 198

F.3d 489, 492 (4th Cir. 1999); *Federal Trade Commission v. Windermere Big Win International, Inc.*, 1999 WL 608715 (N.D.Ill 1999). Furthermore, following the *Grupo* decision, the Southern District of Florida has held that an asset freeze was appropriate in *MAD Financial,* Comm. Fut. L. Rep. ¶ 28,980, 2002 WL 1972063. Additionally, the Eleventh Circuit affirmed an asset freeze in *Levi Strauss,* 51 F.3d at 987 (holding that the "district court had the authority to freeze those assets which could have ben used to satisfy an equitable award of profits").

In light of the relief sought by the Plaintiff, as well as the substantial sum of money Plaintiff paid to the Defendants in the way of commission and fees for transactions violating the CEA,[2]this Court finds that an asset freeze is both necessary and appropriate to maintain the status quo, and to prevent dissipation of funds and frustration of final equitable relief.

At the evidentiary hearing, Defendants expressed concern that freezing their assets would be tantamount to enjoining them from work or from paying their mortgages or legal expenses. This Court finds that freezing the Defendants' assets is appropriate and necessary, and that such a freeze can be fashioned to protect the Defendants' ability to pay legal expenses. Furthermore, this Court recommends that

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[2]Plaintiff asserts that over 98% of UIG customers who opened accounts through UIG collectively lost approximately $6,133,592 between August 4, 2003 and June 30, 2004, and that during this time, UIG generated approximately $4,252,628 in commissions and fees from customers.

the freeze order be fashioned in a manner to permit the release of funds which Defendants demonstrate are not traceable to the illegal activity, and funds as are necessary to pay legal fees. Such an order has survived appeal in *Levi Strauss*, 51 F.3d 987 (holding that the Court could not hold that an asset freeze was too broad until the district court rejects defendants request for modification - in that case the district court had granted the defendants only request for modification, holding that defendants could pay their attorneys' fees).

Conclusion

Accordingly, because the Plaintiff has proven a prima facie case that Defendants have violated the CEA, and because the Plaintiff has adequately demonstrated that future violations are likely to occur absent a preliminary injunction, this Court **RECOMMENDS** that the Plaintiff's Motion for Preliminary Injunction enjoining future violation of the CEA and freezing Defendants' assets as to all Defendants be **GRANTED**.

RECOMMENDATION TO THE DISTRICT COURT

In summary, this Court **RECOMMENDS** the following:

(1) that the Plaintiff's Motion for Preliminary Injunction as to each of the Defendants be **GRANTED** (DE 4);

(2) that such order contain language permitting the release of certain funds to Defendants upon a showing that there is no nexus between the asset and the alleged violation, or that the funds are necessary to pay living or legal expenses. This Court **RECOMMENDS** the order contain the following language, previously utilized by the Southern District of Florida in *Mediaone of Delaware, Inc. v. E & A Beepers and Cellulars,* 43 F.Supp.2d 1348, 1356 (S.D.Fla. 1998):

> This restraint shall include both personal and business assets until a determination can be made as to the appropriate measure of damages and other relief and whether the personal or business assets are the product of Defendants' illegal business. Defendants may submit a request for release of funds to pay for ordinary. . . .personal expenses, including attorneys' fees, if Defendants can demonstrate, through an affidavit or otherwise, a need for such funds. Defendants may also withdraw funds upon written agreement of the parties. . . .

A party shall serve and file written objections, if any, to this Report and Recommendation with the Honorable Daniel T. K. Hurley, District Court Judge for the Southern District of Florida, within ten (10) days of being served with a copy of this Report and Recommendation. *See* 28 U.S.C. § 636(b)(1)(C); *United States v. Warren*, 687 F.2d 347, 348 (11th Cir. 1982), *cert. denied*, 460 U.S. 1087 (1983). Failure to timely file objections shall bar the parties from attacking on appeal the factual findings contained herein. *See LoConte v. Dugger*, 847 F.2d 745 (11th Cir. 1988), *cert. denied*,

488 U.S. 958 (1988); *RTC v. Hallmark Builders, Inc.*, 996 F.2d 1144, 1149 (11th Cir. 1993).

DONE and SUBMITTED in Chambers this 25 day of February, 2005, at West Palm Beach in the Southern District of Florida.

JAMES M. HOPKINS
UNITED STATES MAGISTRATE JUDGE

Copies to:
United States District Court Judge Daniel T. K. Hurley
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