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In The United States District Court
For The District Of New Jersey
Camden Vicinage

Commodity Futures Trading Commission, Plaintiff, **vs.** **Equity Financial Group LLC, Tech Traders, Inc., Tech Traders, Ltd., Magnum Investments, Ltd., Magnum Capital Investments, Ltd., Vincent J. Firth, Robert W. Shimer, Coyt E. Murray, and J. Vernon Abernethy, Defendants.**	**Hon. Robert B. Kugler** **District Court Judge** **Hon. Ann Marie Donio** **Magistrate** **Civil Action No: 04-1512 (RBK)** **MOTION DATE:** **May 5, 2006**

CFTC'S RESPONSE TO ROBERT W. SHIMER AND VINCENT J. FIRTH'S SECOND MOTION FOR SUMMARY JUDGEMENT

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CFTC's RESPONSE TO ROBERT W. SHIMER AND VINCENT J. FIRTH'S SECOND MOTION FOR SUMMARY JUDGEMENT

Plaintiff Commodity Futures Trading Commission ("the Commission") responds to yet another motion for summary judgment filed by Robert W. Shimer ("Shimer") and Vincent J. Firth ("Firth") that seeks relief on grounds already considered and rejected by this court. For the third time,[1] Shimer and Firth argue that Shasta Capital Associates, LLC ("Shasta"), is not a commodity pool, despite the fact that the Court has already ruled that it is one. *See* Opinion filed 10/4/06 [Docket Document No. 266.] As with their last motion for summary judgment and in contrast to the Commission's recent submission of its Motion for Partial Summary Judgment Against Equity Financial Group, LLC, Shimer and Firth [Docket Document Nos. 336 and 337] ("CFTC Motion for Partial Summary Judgment"), Shimer and Firth do not support their motion with any evidence. Their summary judgment motion thus again fails to surmount their initial responsibility of informing the district court of a cognizable legal basis for their motion, and also fails to identify any portions of the record that demonstrate the absence of a genuine issue of material fact.[2]

Shimer and Firth's entire argument lies in the tortured assertion that a feeder fund – like Shasta – that collects and funnels $15 million of investor money to a master or super fund – like Tech Traders – where 100% of the money is supposed to be used for commodities

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[1] *See* Motion to Dismiss, Motion to Dismiss for Lack of Subject Matter Jurisdiction and Motion for Summary Judgment by Robert W. Shimer [Docket Document No. 159] joined by Vincent J. Firth [Docket Document No. 160]; and Motion for Summary Judgment by Robert W. Shimer [Docket Document No. 230] joined in by Vincent J. Firth [Docket Document No. 231.]

[2] Shimer's submission of selected excerpts from the trial record and pleadings in *CFTC v. Heritage Capital Advisory Services, Ltd.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,627, 26,377 (N.D. Ill. 1982) does not constitute evidence in this case.

trading, is nevertheless not a commodity pool unless the principals of that feeder fund and master fund – here Shimer, Firth and Coyt Murray – follow the rules and regulations and trade the money in the name of the pool, rather than treating the funds like Tech Traders' own and claiming they are not subject to regulation.[3] Shimer and Firth's argument, if taken to its logical conclusion, would mean entities like Shasta and Tech Traders, which perpetrated a multi-million commodity fraud, could escape all regulatory scrutiny by failing to follow the rules in structuring commodity pools. This would turn the oft-stated goal of the Commodity Exchange Act, 7 U.S.C. §§ 1 *et seq.* (2002) ("the Act"), to protect investors, on its head. For the reasons stated below, and in the Commission's prior submissions on this subject,[4] Shimer and Firth's arguments are specious and should be again rejected.[5]

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[3] As noted in The Statement of Material Facts in Support of the CFTC's Motion for Partial Summary Judgment Against Equity Financial Group, LLC, Robert W. Shimer and Vincent J. Firth filed in Support of the CFTC's Motion for Partial Summary Judgment (hereinafter "SMF"), Shimer facilitated Tech Traders' trading of Shasta's funds in its own name by entering into an Investment Agreement with Tech Traders that provided pool funds would be traded in the name of Tech Traders. SMF at ¶ 37. Shasta funds were traded in Tech Traders' name. SMF ¶ 9. The Commission asserts that this was a violation of Regulation 4.30, 17 C.F.R. § 4.30 (2005) and that Shimer aided and abetted this violation. CFTC's Memorandum in Support of Motion for Partial Summary Judgment Against Defendants Equity Financial Group, LLC, Robert W. Shimer and Vincent J. Firth ("CFTC Mem.") at 34.

[4] *See* Commission's Response to Equity Defendants' Motion to Dismiss ("CFTC Response") [Docket Document 214] and Response to Robert W. Shimer and Vincent J. Firth's Motion for Summary Judgment ["CFTC Response 2") [Docket Document No. 238.]

[5] The standards for considering a motion for summary judgment are laid out both in the CFTC's Response 2 and in its Motion for Partial Summary Judgment and will not be repeated here. Suffice it to say that the Defendants' argument is purely a legal one and will be responded to as such.

I. A Key Goal of the Act and its Registration Provisions is Customer Protection.

Shimer quotes selectively from the legislative history of the Act in an attempt to support the Defendants' position that the Congress only meant to apply the Act to persons who directly engaged in commodities futures trading. *See* Brief of Defendant Robert W. Shimer in Support of Motion Filed on Behalf of Himself and Motion Filed Separately by Vincent J. Firth Pro Se ... For Summary Judgment ("Shimer Brief") [Docket Document No. 334.] at 22-26. None of his citations support his position. In his discussion of the enactment of the 1974 amendments that created the CFTC, Shimer ignores a central goal of those amendments – customer protection.

As noted by one court, Congress passed the Act in response to concerns of widespread abuses in commodity futures trading and in order to protect investors amid "the volatile and esoteric futures trading complex." *Ping He (Hai Nam) Co. v. Nonferrous Metals, Inc.*, 22 F.Supp.2d 94, 102 (S.D.N.Y. 1998), *vacated in part on other grounds on reconsideration*, 187 F.R.D. 121 (S.D.N.Y. 1999), citing *CFTC v. Schor,* 478 U.S. 833, 836 (1986) (quoting H.R.Rep. No. 93-975, 93d Cong., 2d Sess. 28 at 1 (1974)). Central to the Acts' purpose are its registration requirements, which have been called "the kingpin in this statutory machinery, giving the [CFTC] the information about participants in commodity trading which it so vitally requires to carry out its other statutory functions of monitoring and enforcing the Act." *CFTC v. British American Commodity Options Corp.,* 560 F.2d 135, 139-40 (2d Cir. 1977), *cert. denied,* 438 U.S. 905 (1978).

Because the Act's registration requirements are so vitally important, they apply to nearly every class of professionals who deal in commodities, directly or indirectly. "The registration requirements serve to screen unfit persons from dealings with customers and thus represent an important customer safeguard. To assure that these requirements reach all

persons involved in customer solicitations, the registration requirements have been construed flexibly to require the registration of persons who participate even indirectly in such solicitations." *See* CFTC Interpretative Letter No. 97-44 [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,084, 1997 WL 348744, at 2 (June 9, 1997). In other Congressional deliberations leading up to the 1974 amendments to the Act, not mentioned by Shimer, it was noted that "in order to adequately protect the investing public, registration requirements and fitness checks should be imposed on commodity solicitors, advisors, and all other individuals who are involved either directly or indirectly in influencing or advising the investment of customers' funds." Subcommittee on Special Small Business Problems of the House Permanent Select Committee on Small Business, H.R.Rep. No. 963, 93rd Cong., 2d Sess. at 36-37 (1974).

Firth and Shimer, of course, directly solicited Shasta's investors. *See* SMF ¶¶ 7, 27, 33, 34, 47,127-129. The only thing indirect about their involvement was that they did not directly trade commodity futures contracts on their customers' behalf, but instead transferred the funds to Tech Traders to trade for them. This is a distinction without a difference. Shimer and Firth provide no principled rationale why the fact that the account was traded in the name of Tech Traders, not Shasta, should put them outside the requirements of the Act and their investors outside of its protections. The fact that members of the public access the commodity interest markets through participation in one vehicle that purchases shares in another vehicle that does the actual trading should not diminish the protection commodity pool operator ("CPO") registration affords.

This is the very sort of case that cries out for the protections registration would have brought to the Shasta investors. If Shimer and Firth had sought to register Equity, they

would have had to disclose the "education, the business affiliations for the past ten years, and the present business affiliations of the applicant and of his partners, officers, directors, and persons performing similar functions and of any controlling person thereof." Section 4n(1)(B) of the Act, 7 U.S.C. § 6n (2002). Shimer and Firth would thus have had to disclose their background, including their previous failed investment experiences, including Shimer's with Murray, and Firth's bankruptcies. *See* SMF at ¶¶ 15-21.

A registered CPO is also supposed to furnish statements to each pool participant that contain "complete information as to the current status of all trading accounts in which such participant has an interest." 7 U.S.C. § 6n(4). The Regulations provide detailed instructions about what this information entails. Regulation 4.22, 17 C.F.R. § 4.22 (2005). The Regulations also require that the pool furnish pool participants with an audited Annual Report. Regulation 4.22 (c) and (d). If Shimer and Firth had complied with these requirements, they would have quickly discovered that Tech Traders was not the phenomenal success they told investors it was, but a consistent loser. But Shimer and Firth did not even know the total amount of investor funds Tech Traders held and knew that Murray would never allow an audit of Tech Traders, the entity that really should have been audited here. SMF ¶¶ 88-96, 100-103.

It is disingenuous for the Defendants to argue that the very Regulations Equity should have been following, 4.22, 4.23 and 4.24, somehow prove that Shasta was not a commodity pool. Shimer Brief at 28-29. It was only impossible for Shimer and Firth to comply with these requirements because they never asked Murray for the information. The Commission's Motion for Partial Summary Judgment amply demonstrates that their failure to ask those questions, and their studied ignorance of many red flags about Murray, lead to the massive

losses suffered by their investors. Registration, and its accompanying disclosure requirements, would have prevented that tragedy.

II. The Act's Definition of a CPO and the Commission's Definition of a Pool and Treatment of Feeder Funds Shows that Shasta is a Commodity Pool.

In addition to the fact that treating Shasta as a commodity pool meets with the Congressional goal of customer protection, the statutory definition of a CPO also contemplates that the operator of a feeder fund like Shasta is a CPO. The statutory definition of a CPO is:

> any person engaged in a business that is of the nature of an investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, **either directly or through capital contributions, the sale of stock or other forms of securities**, or otherwise, for the purpose of trading in any commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility…

7 U.S.C. § 1(a)(5)(emphasis added).

As the Commission pointed out in the last round of briefing on this issue, the statutory definition of a CPO contemplates indirect investments in commodity interests through vehicles such as the shares in a limited liability corporation that Shasta investors purchased. *See* CFTC Response 2 at 9; Exhibit 49 submitted with CFTC's Motion for Partial Summary Judgment.

The Commission defined a pool in Regulation 4.10(d):

> *Pool* means any investment trust, syndicate, or similar form of enterprise operated for **the purpose of trading** commodity interests.

Although there is nothing in this definition that states explicitly that a feeder fund such as Shasta that engages in commodity interest trading indirectly is a commodity pool, other sections of Regulation 4.10 show that feeder funds are commodity pools. For example,

Regulation 4.10(d)(4) defines an "investee pool" to mean "any pool in which another pool or account participates or invests, *e.g.*, as a limited partner thereof," and Regulation 4.10(d)(5) defines a "major investee pool" to mean "with respect to a pool, any investee pool that is allocated or intended to be allocated at least ten percent of the net asset value of the pool." 17 C.F.R. § 4.10 (2005). These definitions are important because, among other things, they trigger certain disclosure requirements under Regulation 4.21. [6]

Support for the proposition that a feeder/investor fund is itself a commodity pool is also found in Appendix A to Part 4 – Guidance on the Application of Rule 4.13(a)(3) in the *Fund-of-Funds* Context (emphasis added). 17 C.F.R. § 4.13 (2005). In 2003, the Commission adopted additional exemptions from CPO registration, in new Regulations 4.13(a)(3) and (a)(4).[7] Specifically, the availability of the exemption in Regulation 4.13(a)(3) is based on a CPO meeting what has come to be called a "de minimis" level of trading in the commodity pool at issue and accepting into the pool only participants with a certain specified level of sophistication.[8] In response to comments on the proposed

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[6] For example, Regulation 4.21(e)(3) requires a CPO's Disclosure Document to identify each "major investee pool, the operator of such investee pool, and each principal of the operator thereof" and Regulation 4.21(j)(iv) requires the Document to provide a full description of any conflict of interest regarding any aspect of the pool on the part of "the commodity pool operator of any major investee pool." If Shimer and Firth had properly registered Shasta, they would have had to reveal that Tech Traders was the "investee" pool, a fact they tried very hard to shield from prospective and many actual investors. *See* SMF at ¶¶ 40, 51, 129.

[7] 68 FR 47221 (August 8, 2003). In order to qualify for these exemptions, an applicant must file a notice of exemption from CPO registration with the National Futures Association ("NFA"), the self-regulatory organization that handles some registration duties for the Commission. Regulation 4.13(b). Equity never filed for such an exemption. SMF ¶ 3.

[8] Regulation 4.13(a)(4) has no trading limit criteria, but the specified level of participant sophistication is much higher than that of Regulation 4.13(a)(3).

regulation, in adopting the final regulation the Commission also adopted the Appendix, to provide guidance on how to calculate this level of trading in the context of a fund-of-funds – which also is commonly known as a master/feeder or investor/investee fund. Among other things, the Appendix states that it provides guidance "on the application of the trading limits of Rule 4.13(a)(3)(ii) to commodity pool operators (CPOs) who operate 'fund-of-funds' and that for the purpose of the Appendix, it is presumed that "where *the investor fund CPO* is relying on its own computations, the investor fund is participating in each investee fund that trades commodity interests as a passive investor, with limited liability. . . ." (emphasis added).

Further, when the Commission adopted these additional CPO registration exemptions, it also amended Regulations 4.21 and 4.22 so as to remove from these rules duplicative requirements in the master/feeder fund context. As the Commission explained in proposing this action, which is (now) reflected in Regulations 4.21(a)(2) and 4.22(a)(4), "[w]here the prospective or actual participant of a commodity pool *is another commodity pool*," the CPO need only deliver a Disclosure Document and distribute Account Statements and an Annual Report to the pool operator of the other commodity pool" (emphasis added).[9] 17 C.F.R. §§ 4.21 and 4.22 (2005).

In accordance with the Commission's position that a feeder fund is a commodity pool, Commission staff has issued guidance to CPOs on how to make fund-of-fund disclosures. *See* CPO Annual Report Letters for 1999 and 2000, attached as Attachments 1

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[9] 68 FR 12629 (March 17, 2003). In its proposal the Commission acknowledged a staff letter, No. 02-102 (August 29, 2002) wherein staff had issued similar relief. That letter refers to other letters, all of which support the view stated by the Commission.

and 2 hereto. This guidance shows that there are many CPOs that are feeder funds that are registered under the Act.

III. The Court's Finding that Shasta is a Commodity Pool is Fully in Accord with Previous Case Law.

The whole premise for Shimer and Firth to resurrect their argument that Shasta is not a commodity pool for the third time is the supposed "evidence" Shimer unearthed through a federal records search of a 24 year old trial record in the *Heritage Capital* case. They argue that this "evidence" shows that the commodity trading account in that case was in the name of Heritage Capital, and that therefore the court's finding in that case that Heritage Capital was a commodity pool is not relevant precedent for this case. *See* Shimer Brief at 7-11. The Defendants continue to fail to cite to any evidence in **this** case that would entitle them to summary judgment against the Commission. Shimer's support for requesting that the Court revisit this issue is the supposed "fact" that the trading account being traded by Robert Serhant through his company Financial Partners, Ltd was actually titled in the name of Heritage Capital Advisory Service Ltd. Shimer Brief at 6-10. The "evidence" Shimer cites does not clear up the record on the name on any trading accounts.[10] But the name on the trading accounts is not relevant here. Whatever that name was, that fact was not at issue in

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[10] Shimer points to two "facts" to show that the trading account was in the name of Heritage Capital in that case – some promotional material obtained by a Heritage investor and portions of the Complaint filed by the CFTC in that matter. However, as described in the CFTC's Response 2 at 4, the mastermind of that fraud, Robert Serhant, stated he was only going to invest $3,000 out of every $100,000 of investor money in futures contracts but gambled it all on futures, losing $21 million of the $51 million investors entrusted to him. Thus, any statements Serhant made in promotional material about what he was going to do with investor money are suspect. The select pages of the Complaint Shimer chose to submit also do not indicate whose name the trading accounts were in.

the *Heritage* court's decision that Heritage was a commodity pool and it was not a deciding factor in this Court's previous decision.

The issue in *Heritage Capital* was whether Heritage was a commodity pool when the ultimate investment decisions were made by Serhant through his company Financial Partners, Ltd. *See* ¶21,627 and 26,387. The court found that, although in a traditional commodity pool, the operator usually exercise control over the investment decisions[11], the definition of a commodity pool does not require such control. *Id.* It found the salient features of a commodity pool to be "1) all investors funds are placed in a single account, 2) transactions are executed on behalf of the entire account without allocation to any particular investor 3) investors' profits and losses are then allocated by shares to individual investors based on their *pro rata* contribution to the fund. *Id,* citing *Meredith v. ContiCommodity Services, Inc.,* [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,108 (D.D.C.1980). The court did not find that the name on the commodity trading account was at all a determining factor in whether Heritage Capital was a pool.

Like the *Heritage* court, this Court also found that "[t]the fact that Shasta did not invest in commodity futures directly, but instead transferred funds to Tech Traders to invest

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[11] Shimer's selective citation to the trial testimony of CFTC investigator Charlotte Ohlmiller does not support his position that Shasta is not a commodity pool. In the testimony Shimer points to, Ms. Ohlmiller was referring to what a CPO does as a "general matter", that is, in a traditional commodity pool. *See* Shimer Brief at 31-32, Exhibit E at 174. If one reads the rest of the excerpt of her testimony that Shimer submitted, when asked specifically about the "essential nature of this investment program (the Heritage commodity pool)" which caused her to conclude that was a commodity pool, she stated "[a]side from the fact that money is collected from the customers and put into common funds, the customers expected to profit or lose on a pro rata basis according to the amounts of money that they initially invested with Jeffrey and Ward Weaver." Exhibit E at 178-79. She said nothing about the name on the commodity account being essential to finding that Heritage was a commodity pool.

does not affect Shasta's status as a commodity pool." Order at 9. The Court found "defendants' reading of the *Lopez* Court's language is far too literal" and that "[t]he appellation given the actual transaction is irrelevant, so long as it is a pooled fund and not conducted in the names of individual customer accounts." Order at 10. The Court found that Shasta satisfied the four factors of the *Lopez* test[12] and that "Shasta is precisely the form of entity Congress authorized the CFTC to regulate as a commodity pool." Order at 9.

Shimer and Firth have not disputed the facts set forth by the Commission and found by this Court which show that 1) the Shasta investors' money was pooled in Shimer's escrow account, 2) the funds were then transferred *en masse* to Tech Traders to be invested in commodity futures, without distinguishing between the funds of individual investors, 3) gains from Tech Traders' trading were to be allocated *pro rata* and 4) trades were made on behalf of the pool rather than in the name of individual investors. *See* Order at 8-9. They have not cited any case, or pointed to any statutory or regulatory provision that requires that a trading account be traded in the **name** of pool before that entity can be found to be a commodity pool. Nor have they given this Court any principled reason why the name on the

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[12] Those factors are 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; 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. *Lopez v. Dean Witter Reynolds, Inc.* 805 F.2d 880, 884 (9th Cir. 1986).

account should make any difference. For these reasons, their third attempt to escape liability on an overly literal reading of the *Lopez* decision should be denied.[13]

IV. The Equity Defendants' Fraudulent Conduct was "In Connection With" Commodity Futures Trading and Violated Section 4b(a)(2)(i)-(iii) of the Act.

Defendants also resurrect their argument that there is no fraud claim under Section 4b, 7 U.S.C. § 6b,[14] against them because the absence of a commodity trading account in Shasta's name means the Shasta investors have not been cheated and defrauded "in connection with" commodity futures trading. *See* Shimer Brief at 35-39. The Defendants raise no new arguments and the Commission refers the Court to its previous responses to this argument at CFTC Response at 8-10 and CFTC Response 2 at 10-13. The Defendants do provide a new citation that they allege supports their theory that investors who invest in an investment vehicle that does not trade their funds in the investment vehicle's name is not a commodity pool – the Supreme Court case of *Merrill Lynch, Pierce, Fenner & Smith v. J.J. Curran,* 456 U.S. 353 (1982). This case, like all of the other cases Defendants cite, is inapposite. *Curran* held that the Act granted futures investors an implied private right of action to pursue actions for fraud under § 4b. There is nothing in the decision that states that

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[13] Although, as this Court found, Shasta satisfies the four factors of the *Lopez* test, the Commission notes that another district court recently declined to follow *Lopez's* four part test, finding that "[i]ts adoption of four requirements for a commodity pool is not controlling on the issue of whether a person is a 'commodity pool operator,' a defined statutory term that does not require the existence of a legitimate commodity pool, only that the person be engaged in a business 'in the nature of an investment trust' or similar form of enterprise who, in connection with that business solicits, accepts or receives from others, funds in any of the various enumerated forms 'for the purpose of trading in a commodity.'" *CFTC v. Brockbank,* 2006 WL 223835, at 4 (D. Utah 2006) (attached at Attachment 3 hereto).

[14] 7 U.S.C. § 6(b) (2002).

only those who hold commodity futures accounts in their own names are entitled to the protections of the Act. Moreover, the *Curran* case was superseded when Congress enacted Section 22 of the Act, 7 U.S.C. § 25, and explicitly enumerated private rights of action as part of the Futures Trading Act of 1982, Pub.L. 97-444, § 235, 96 Stat. 2294, 2322-24 (Jan. 11, 1983) (codified at 7 U.S.C. § 25 (1988)). This, of course, is not a private action. However, the Commission notes that § 22 provides that "any person…who violates this Act or who willfully aids, abets, counsels, induces, or procures the commission of a violation of this Act shall be liable for actual damages ….caused by such violation to any other person….who deposited with or paid to such person money, securities or property (or incurred debt in lieu thereof) in connection with any order to make such contract…" 7 U.S.C. § 25(a)(1)(B) . The Shasta investors deposited their money in Shimer's attorney escrow account to invest with Tech Traders in commodity futures contracts. They are just the sort of people the Act was designed to protect.

V. The Commission's Count V Allegations Against Shimer for Aiding and Abetting A Violation of Regulation 4.30 Do Not Require A Finding that Shasta was a Commodity Pool.

Defendants do not bother to repeat their arguments why the Commission's charge against Shimer for aiding and abetting Tech Traders' violation of Regulation 4.30 should be dismissed against Shimer. This is likely because they have no good argument for its dismissal. The Commission has amply supported this charge against Shimer in its Motion for Partial Summary Judgment and the Commission refers the Court to its Memorandum at 34-35. As set out there, Tech Traders was the commodity trading advisor ("CTA") for Shasta in that, for compensation or profit, it advised the Shasta commodity pool as to the advisability of trading in commodity futures contracts. As CTA for the Shasta pool, Tech

Traders violated Regulation 4.30 by accepting their funds and trading them in its accounts at futures commission merchants ("FCMs") under its own name. The Defendants have provided no evidence that Shasta's funds were not traded in Tech Traders' name. In fact, they attempt to make a nullity of this regulatory prohibition by arguing that the fact that Shimer facilitated Tech Traders' violation of Regulation 4.30 by allowing Tech Traders to trade Shasta's investors' funds in its own name takes those investors entirely outside the protection of the Act. Thus, by the Defendants' own admission, Shimer is liable for aiding and abetting this violation.

VI. Conclusion

Although this Court has already ruled that Shasta was a commodity pool, the Defendants persist in rearguing what should be a settled point in this litigation. In doing so, they do not cite to any evidence in this case or any law that supports their position. Digging out selective portions of a 24 year old trial record and pleadings for a proposition that was not even at issue in the *Heritage Capital* case is not going to advance this litigation. The statute, the Commission's regulations promulgated under that statute, the case law and this Court's previous ruling all fully support the finding that Shasta was a commodity pool. And as the Commission's Motion for Partial Summary Judgment shows, these Defendants and their conduit Equity, through their deliberate ignorance of numerous red flags, committed a massive fraud on Shasta's 65 investors – a fraud from which these investors have suffered over $8 million in losses. *See* CFTC Mem. at 40. Defendants' second motion for summary judgment therefore should be denied.

Date: April 20, 2006

Respectfully submitted,

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ATTACHMENT

1

January 19, 2000

To: All Commodity Pool Operators

Attention: Chief Financial Officer

Subject: 1999 Annual Reports for Commodity Pools

The Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission") is sending this letter to all registered commodity pool operators ("CPOs") to assist CPOs and their public accountants in complying with Part 4 of the Commission's regulations under the Commodity Exchange Act ("CEAct") in connection with the preparation and filing of a pool's 1999 annual financial report.

Last year, Commission staff reviewed more than 1,100 annual reports filed by CPOs for their commodity pools. About 82% of these reports were accepted as filed. That is a significant improvement from the prior year, when 77% of the annual reports were accepted as filed.

In our last letter regarding pool annual reports (February 10, 1999), we described certain recurring deficiencies in prior filings. Both this letter and the February 10, 1999, letter are available at our website at http://www.cftc.gov/tm/mgdfund.htm. Therefore, we will not repeat the items mentioned in our prior letter in detail, but will expand on some of them. In particular, please see **Fund of Funds Considerations** below for an update on that important topic. Also, many of the deficiencies noted below occur in reports for offshore pools. Accordingly, it may be helpful for you to share this letter with your offshore correspondents and their local auditors.

In order to avoid some of the most common and easily remedied deficiencies (they are discussed in detail in last year's letter), please do the following:

· File **one copy** of the report with National Futures Association (NFA) and **two copies** with the Commission at the regional office in whose jurisdiction the CPO's principal place of business is located (See Attachment A for addresses).[1]

· File the report as soon as possible, but no later than the due date. For pools with a December 31, 1999 year-end, the due date is Thursday, March 30, 2000 (unless an extension of time has been granted).

· If the pool is operating under a Rule 4.7 or 4.12 exemption, the rule requires that a notation of that fact be made on the cover page of the report.

· Report special allocations of partnership equity as required by CFTC Interpretive Letter 94-3, *Special Allocations of Investment Partnership Equity* (CCH ¶25943).

· Include information concerning net asset values or schedules of participants' interests where that is required.

· Include a signed oath or affirmation with each and every copy of the report filed with NFA and the Commission. (Binding the oath as part of the report package or attaching it to the cover page is a helpful practice followed by a number of CPOs.)

Fund of Funds Considerations

The Division is particularly concerned with the level of disclosure regarding a pool's investments in other investment companies. This one topic accounted for about 75% of the non-compliance letters we sent for 1998 annual reports.

Regulation 4.22(c)(5) requires annual reports to include appropriate disclosures and such further material information as necessary to make the statements not misleading. (Similar obligations are found in Regulations 4.7(a)(2)(iii)(A)(3) and 4.12(b)(2)(iii).) The Division believes that complete disclosure to the participants in a commodity pool requires that the pool's financial statements provide them information about other funds to which the pool devotes significant portions of its capital ("major investee funds"). The objective is to allow the participant to see the performance of the pool's major assets and the fees associated with these investments. At a minimum, the pool's financial statements should disclose, for each major investee fund:

(1) the name of the fund,

(2) the carrying value of the investment,

(3) liquidity information (such as limitations on withdrawals from the investee fund), and

(4) summary income statement information, which should identify fees paid by the investee pool to its CPO and CTAs *expressed in dollars*.

This disclosure is necessary regardless of whether the investee funds are commodity pools.

Where the pool's investment in an investee fund is greater than or equal to 10% of the pool's net assets, the investee fund is considered a major investee fund. *See* Regulation 4.10(d)(5). Moreover, once there is at least one 10% investee, disclosure is required for all investees (smaller funds may be aggregated and reported as a single group). The total of the capsule information in the notes to the report should agree with the single-line reported on the statement of operations for the investor fund's investment in other funds.

Even if no single investment is 10% of the reporting pool's net assets, if the aggregate investment in other funds is at least 20%, the CPO should strongly consider providing the information discussed above with respect to the pool's investments in other funds, and should be prepared to explain a failure to do so. The CPO should exercise discretion in determining the best method of presenting this information. While it may not be necessary to provide information on each of the individual investee funds, the CPO should find an appropriate method of classifying the investments and reporting on each class.

In addition to noting the issues discussed in this letter, CPOs and their accountants should be familiar with the AICPA Practice Aid *Audits of Futures Commission Merchants, Introducing Brokers, and Commodity Pools*. Enclosed as Attachment B is an illustration that satisfies the objectives of fund-of-funds reporting.

If a CPO or its accountant has questions concerning the matters discussed in this letter or the reporting rules, they should contact the staff member identified in Attachment A.

Thank you for your cooperation.

Very truly yours,

Henry J. Matecki

Acting Chief Accountant

[1] While Regulation 4.2 directs that materials required under Part 4 be filed at the Commission's Washington office, CPOs are encouraged, and by this letter authorized (pursuant to Regulations 4.12(a) and 140.93(a)(1)), instead to file pool annual reports at the appropriate regional office of the Commission.

ADDRESSES OF CFTC's DIVISION OF TRADING AND MARKETS OFFICES

Regional Offices and Contacts	Location of CPO's Principal Office
Eastern Region One World Trade Center Suite 3747 New York, NY 10048 Ronald A. Carletta Phone: 212-488-1289 FAX: 212-466-5575 E-Mail: rcarletta@cftc.gov	All states east of the Mississippi River, *except* Illinois, Indiana, Michigan, Ohio, and Wisconsin. Any location outside of the United States
Central Region 300 South Riverside Plaza Suite 1600 North Chicago, IL 60606 John S. Dixon Phone: 312-886-3207 FAX: 312-353-3690 E-Mail: jdixon@cftc.gov	Illinois, Indiana, Michigan, Ohio, and Wisconsin
Southwest Region 4900 Main Street Suite 721 Kansas City, MO 64112 Ralph L. White	All states west of the Mississippi River

Phone: 816-931-9502 FAX: 816-931-9643 E-Mail: rwhite@cftc.gov	

NFA ADDRESS

National Futures Association

Compliance Department

200 West Madison 16th Floor

Chicago, IL 60606

Phone: 312-781-1300

ILLUSTRATION - FUND OF FUNDS DISCLOSURES

Note X. Investments

As of December 31, 1999, ABC Fund invested in other funds, none of which were related parties. The Fund's investments are summarized below based on the investment objectives of the specific funds, as described in the disclosure documents for those funds:

Investment Objective	Fair Value
[Objective 1]	$ 700,000
[Objective 2]	550,000
[Objective 3]	500,000
Other	155,485
Total	$1,905,485

The following table summarizes ABC Fund's investments in other funds as of December 31, 1999. Funds in which ABC Fund invested 10% or more of its net assets are individually identified, while smaller investments in three other funds are aggregated. The management agreements of the investee funds provide for compensation to the managers in the form of fees ranging from 1% to 3% annually of net assets and performance incentive fees ranging from 5% to 25% of net profits earned.

Investment	% of ABC's Net Assets	Fair Value	Income (Loss)	Fees		Redemptions
				Mgmt.	Incentive	Permitted
Hejmat Fund Ltd.	11.2	$ 500,000	$145,000	$ 5,200	$30,000	Quarterly
Carron Int'l Fund	10.7	475,000	118,000	4,800	24,000	Monthly
Marvelous Fund NV	10.1	450,000	(24,000)	4,500	0	Semi-Annual
Other funds	10.8	480,485	18,221	5,500	3,500	Monthly-Annually
Total	42.8%	$1,905,485	$257,221	$20,000	$57,500	

Updated March 31, 2006

ATTACHMENT

2

January 12, 2001

To: All Commodity Pool Operators
Attention: Chief Financial Officer

Subject: 2000 Annual Reports for Commodity Pools

This is the third annual letter that the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission") is sending to all registered commodity pool operators ("CPOs") to share the results of our experience reviewing prior years' annual pool reports. These letters are intended to assist CPOs and their public accountants in complying with Part 4 of the Commission's regulations under the Commodity Exchange Act ("CEAct") in connection with the preparation and filing of a pool's annual financial report.

The total number of reports filed increased in each of the last three years. About 86% of the 1999 reports were acceptable as filed, compared to 82% of the1998 reports and 77% of the 1997 filings. Although the trend is favorable, there is room for further improvement.

In our previous letters regarding pool annual reports (dated January 19, 2000 and February 10, 1999), we described certain recurring deficiencies. Both this letter and those letters are available at our website at www.cftc.gov/tm/mgdfund.htm. Therefore, we will not repeat all the details mentioned in our prior letters, but will emphasize and expand on some of them. In particular, please see Fund of Funds Considerations below for an update on that important topic. Because many of the deficiencies noted below occur in reports for offshore pools, it may be helpful for you to share this letter with your offshore correspondents and their local auditors.

In order to avoid some of the most common and easily remedied deficiencies, please do the following:

· File one copy of the report with the National Futures Association (NFA) and two copies with the Commission at the regional office in whose jurisdiction the CPO's principal place of business is located (See Attachment A for addresses).[1]

· File the report as soon as possible, but no later than the due date. For pools with a December 31, 2000 year-end, the due date is Monday, April 2, 2001 (unless an extension of time has been granted). CPOs operating a fund-of-funds pool should review the new streamlined procedures described in the revised Regulation 4.22(f)(2) for requesting an extended due date (this topic is discussed later in this letter).

· If the pool is operating under a Rule 4.7 or 4.12 exemption, the rule requires that a notation of that fact be made on the cover page of the report. Note that, effective August 4, 2000, the 4.7 rules were amended making them available to more CPOs and commodity trading advisors ("CTAs") in more situations. The new rules were published at 65 Fed. Reg. 47848 and are available at the CFTC website at www.cftc.gov/foia/fedreg00/000804b.htm or .pdf. Please note that the revised 4.7 resulted in a renumbering from the former rules. A cross-reference page is included at the end of the Federal Register notice.

· Report special allocations of partnership equity as required by CFTC Interpretive Letter 94-3, *Special Allocations of Investment Partnership Equity* (CCH ¶25943). This document is available on the CFTC website at www.cftc.gov/tm/94-03.htm.

· Include information concerning net asset values or schedules of participants' interests where that is required.

· Include a signed oath or affirmation with each and every copy of the report filed with NFA, the Commission and all pool participants. (Binding the oath as part of the report package or attaching it to the cover page is a helpful practice followed by a number of CPOs.)

Applicability of GAAP to Commodity Pools' Annual Financial Statements

In reviewing 1999 annual reports we noted instances where CPOs filed pool financial statements that failed to comply with generally accepted accounting principles ("GAAP"). CFTC rules require that financial statements of pools be presented and computed in accordance with GAAP. That requirement applies even when financial statements are exempt from independent audit, such as those of pools qualifying under Regulation 4.7. Significant departures from GAAP may necessitate revising a pool's financial statements and sending them to investors along with revised account statements.

Schedule of Investments Likely to be Required by GAAP

Non-public investment partnerships have been required to include a schedule of investments as specified by the AICPA Statement of Position 95-2, *Financial Reporting by Nonpublic Investment Partnerships* ("SOP 95-2"). Investment partnerships that are commodity pools subject to regulation under the Commodity Exchange Act of 1974 are currently exempt from SOP 95-2. That exemption is likely to be revoked by an SOP that is being finalized by the AICPA. The rationale for revocation is to help improve the transparency and comparability of financial statement disclosures made by commodity pools, hedge funds, and other kinds of funds. The amended SOP would be effective for commodity pools' financial statements for periods ending after December 15, 2001. (The amended SOP would encourage application of these principles to earlier periods). It is likely to require that commodity pools' financial statements include a schedule of investments as prescribed by SOP 95-2. (Check website www.AICPA.org for the current status of this proposal.) While this will not be a required schedule for December 31, 2000 annual reports, CPOs should consider the impact of this schedule on periodic reports which will be prepared during 2001 and future annual reports.

Final Reports

When a CPO ceases trading, the CPO must file a final report for each of its pools. The final report should be in the same format and include the same information as the annual report, even if the final report is not for a full 12 month period. A CPO should emphasize when it intends a report to be its final report. A legend on the cover of the report is an effective way to do so.

Fund of Funds Considerations

The Division of Trading and Markets is particularly concerned with the level of disclosure regarding a pool's investments in other investment companies. This one topic accounted for a substantial portion of the non-compliance letters we sent for 1999 and 1998 annual reports.

Regulation 4.22(c)(5) requires annual reports to include appropriate disclosures and such further material information as necessary to make the statements not misleading. (Similar obligations are found in Regulations 4.7(b)(3)(C) and 4.12(b)(2)(iii)(A)). The Division of Trading and Markets believes that complete disclosure to the participants in a commodity pool requires that the pool's financial statements provide them information about other funds to which the pool devotes significant portions of its capital ("major investee funds"). The objective is to allow the participant to see the performance of the pool's major assets and the fees associated with these investments.

If a pool's investment in an investee fund is greater than or equal to ten percent of the pool's net assets, the investee fund is considered a major investee fund. See Regulation 4.10(d)(5). Moreover, once there is at least one major investee fund, disclosure for all investee funds is appropriate (smaller funds may be aggregated and reported as a single group). The total of the net income or loss for each investee fund in the capsule information in the notes to the financial statements should agree with the single-line reported on the statement of operations for the investor fund's investment in other funds.

At a minimum, the pool's financial statements should disclose, for each major investee fund:

(1) The name of the fund,

(2) The carrying value of the investment,

(3) Liquidity information (such as limitations on withdrawals from the investee fund), and

(4) The summary income statement information discussed in Regulation 4.22(e). This should include fees paid by the investee pool expressed in dollars. In those unusual cases where dollar amounts cannot be obtained and are unknown to the CPO, a statement to that effect should be made by the CPO and the percentages used by the investee to calculate fees should be reported as illustrated in Attachment B to this letter.

This disclosure should be made regardless of whether the investee funds are commodity pools.

Even if no single investment is ten percent of the reporting pool's net assets, if the aggregate investment in other funds is at least 20 percent, the CPO should strongly consider providing the information discussed above with respect to the pool's investments in other funds, and should be prepared to justify a failure to do so. The CPO should exercise discretion in determining the best method of presenting this information. While it may not be necessary to provide information on each of the individual investee funds, the CPO should find an appropriate method of classifying the investments and reporting on each class.

Enclosed as Attachment B is an illustration that satisfies the objectives of fund-of-funds reporting.

In cases where a pool has invested all, or substantially all, of its net assets in one other pool (such as in a master-feeder structure), complete financial statements of the investee pool should be included with those of the investor pool. The financial statements of the investee pool should also include disclosures described herein for its own investee pools.

Extended Due Date for Fund-of-Funds Pools

Revisions to Regulation 4.22(f) make it easier for fund of fund pools to obtain extensions of time for filing their annual reports. (65 Fed. Reg. 80741 (December 26, 2000)). These revised regulations are available at the CFTC website (www.cftc.gov/foia/fedreg00/001226a.htm or .pdf.) These revisions to Regulation 4.22(f) would permit CPOs to file a claim for an extension of time to file the pool's annual report where the pool is invested in other collective investment vehicles, and the CPO's independent accountant cannot obtain the information necessary to comply with the rule in a timely manner.

Notices for the first year: The CPO's first notice claiming the extension must be filed within 90 days after the end of the pool's fiscal year (that is, by the normal deadline for filing the annual report). This notice must contain the following:

1) The name, main business address, main telephone number and the National Futures Association registration identification number of the commodity pool operator, and the name and NFA identification number of the commodity pool

2) The date by which the Annual Report will be distributed and filed (the "Extended Date"). The Extended Date must be no more than 150 calendar days after the end of the pool's fiscal year.

3) Representations by the commodity pool operator that:

(A) The pool for which the Annual Report is being prepared has investments in one or more collective investment vehicles (the "Investments");

(B) The commodity pool operator has been informed by the certified public accountant selected to audit the commodity pool's financial statements that specified information establishing the value of the Investments is necessary in order for the accountant to render

an opinion on the commodity pool's financial statements. The notice must include the name of the accountant; and

(C) The information specified by the accountant cannot be obtained in sufficient time for the Annual Report to be prepared, audited, and distributed before the Extended Date.

Before claiming the extension, the CPO must analyze the circumstances related to the operation of its pool and specify the period for which relief is needed. The CPO is not required to obtain a written statement from the independent accountant selected to audit the pool confirming that information in the CPO's notice. As noted above, however, the CPO will be required to name the independent accountant who has informed the CPO of the necessity of that information.

Notices for subsequent years: In subsequent years, the requisite representations may be made in a statement filed at the same time as the annual report.

The CPO responsible for the pool's operation must sign the notice or statement.

Applicability to Regulation 4.7 Pools. Under Regulation 4.7, CPOs may claim relief from the requirement that the exempt pool's financial statements distributed to pool participants be certified by an independent public accountant. Most CPOs operating pools for which relief under Regulation 4.7 has been claimed, nonetheless include certified financial statements in their annual reports. In changing Rule 4.22, the Commission noted that it did not wish to discourage this practice and it will allow such CPOs to claim the relief provided in Regulation 4.22(f)(2).

These regulations are applicable for fund-of-funds situations only. CPOs requesting extensions for other reasons or for whom the automatic extension is insufficient must follow the provisions of 4.22(f)(1) and file those requests with the CFTC's Washington office.

All CPOs that have requested filing extensions for their fund-of-funds pools in the past must re-file under this new rule provision. The extensions granted in the past are no longer applicable.

Conclusion

In addition to noting the issues discussed in this letter, CPOs and their accountants should be familiar with the AICPA Practice Aid *Audits of Futures Commission Merchants, Introducing Brokers, and Commodity Pools*.

If you or your accountant have any questions on the foregoing, please feel free to contact the appropriate regional CFTC staff member listed in Attachment A to this letter.

Thank you for your attention to these matters.

Very truly yours,

John C. Lawton
Acting Director
Division of Trading and Markets

ADDRESSES OF CFTC's DIVISION OF TRADING AND MARKETS OFFICES

Regional Offices and Contacts	Location of CPO's Principal Office
Eastern Region One World Trade Center	All states east of the Mississippi River, *except* Illinois, Indiana, Michigan, Ohio, and Wisconsin.

Suite 3747 New York, NY 10048 Ronald A. Carletta Phone: 212-488-1289 FAX: 212-466-5575 E-Mail: rcarletta@cftc.gov	Any location outside of the United States
Central Region 300 South Riverside Plaza Suite 1600 North Chicago, IL 60606 John S. Dixon Phone: 312-886-3207 FAX: 312-353-3690 E-Mail: jdixon@cftc.gov	Illinois, Indiana, Michigan, Ohio, and Wisconsin
Southwest Region 4900 Main Street Suite 721 Kansas City, MO 64112 Ralph L. White Phone: 816-931-9502 FAX: 816-931-9643 E-Mail: rwhite@cftc.gov	All states west of the Mississippi River

NFA ADDRESS

National Futures Association
Compliance Department
200 West Madison 16th Floor
Chicago, IL 60606

Phone: 312-781-1300
website: nfa.futures.org

ILLUSTRATION - FUND OF FUNDS DISCLOSURES

Note X. Investments

As of December 31, 2000, ABC Fund invested in other funds, none of which were related parties. The Fund's investments are summarized below based on the investment objectives of the specific funds, as described in the disclosure documents for those funds:

Investment Objective	Fair Value
[Objective 1]	$ 700,000
[Objective 2]	550,000

[Objective 3]	500,000
[Other]	155,485
Total	$1,905,485

The following table summarizes ABC Fund's investments in other funds as of December 31, 2000. Funds in which ABC Fund invested 10% or more of its net assets are individually identified, while smaller investments in three other funds are aggregated . The management agreements of the investee funds provide for compensation to the managers in the form of fees ranging from 1% to 3% annually of net assets and performance incentive fees ranging from 5% to 25% of net profits earned.

Investment	% of ABC's Net Assets	Fair Value	Income (Loss)	Fees		Rede Per
				Mgnt	Incentive	
Hejmat Fund Ltd.	11.2	$ 500,000	$145,000	$ 5,200	$30,000	Quarterly
Carron Int'l Fund	10.7	475,000	118,000	4,800	24,000	Monthly
Marvelous Fund NV	10.1	450,000	(24,000)	4,500	0	Semi-Ani
Other funds:	10.8	480,485	18,221	5,500	3,500	Monthly-,
Total	42.8%	$1,905,485	$257,221	$20,000	$57,500	

An alternative illustrative table, for *unusual cases,* where the fee information cannot be obtained is shown below:

Investment	% of ABC's Net Assets	Fair Value	Income (Loss)	Fees		Rede Per
				Mgnt	Incentive	
Hejmat Fund Ltd.	11.2	$ 500,000	$145,000	$ 5,200	$30,000	Quarterl
Marvelous Fund NV	10.1	450,000	(24,000)	4,500	0	Semi-Ar
Other funds:	10.8	480,485	18,221	5,500	3,500	Monthly·
Subtotal	32.1	1,430,485	139,221	$15,200	$33,500	
Carron Int'l Fund	10.7	475,000	118,000	*	*	Monthly
Total	42.8%	$1,905,485	$257,221			

* = The fund operator is not able to obtain the specific fee amounts for this fund and does not know what those amour However, management fees are computed based on 1% per year of net asset balances at the beginning of each n incentive fees are computed based on 20% per year of net income.

1 While Regulation 4.2 directs that materials required under Part 4 be filed at the Commission's Washington office, CPOs are strongly encouraged, and by this letter authorized (pursuant to Regulation 4.12(a) and 140.93(a)(1)), instead to file pool annual reports at the appropriate regional office of the Commission.

Updated March 31, 2006

ATTACHMENT

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Slip Copy, 2006 WL 223835 (D.Utah)

(Cite as: 2006 WL 223835 (D.Utah))

H

Motions, Pleadings and Filings

Only the Westlaw citation is currently available.

United States District Court,
D. Utah, Central Division.
COMMODITY FUTURES TRADING COMMISSION, Plaintiff,
v.
Stephen W. BROCKBANK, Gahma Corporation, Stephen W. Brockbank, John Garrett, Allen Andersen, Robert Heninger, et al., Defendants.
No. 2:00-CV-622 TS.

Jan. 30, 2006.

Carlie Christensen, US Attorney's Office, Robert J. Greenwald, Rosemary Hollinger, Ava M. Gould, Camille M. Arnold, US Commodity Futures Trading Commission, Chicago, IL, for Plaintiff.

Edward W. McBride, Jr., Otto & McBride, Salt Lake City, UT, Donald J. Purser, Law Offices of Donald Joseph Purser, Murray, UT, for Intervenor Plaintiff.

Stephen W. Brockbank, Saratoga Springs, UT, pro se.

Robert Heninger, Auburn, WA, pro se.

Dale B. Kimsey, Sandy, UT, pro se.

Carol J. Love, West Jordan, UT, Randy S. Ludlow, Birma, Birma, Edward W. McBride, Jr., Otto & McBride, John T. Walsh, Anna W. Drake, Deanna Lee Garrett, Dennis L. Mangrum, Salt Lake City, UT, John Garrett, Farmington, UT, Allen Andersen, Riverton, UT, Dale B. Kimsey, Sandy, UT, Donald J. Purser, Law Offices of Donald Joseph Purser, Murray, UT, for Defendants.

MEMORANDUM DECISION AND ORDER DENYING GAHMA DEFENDANTS' MOTION TO DISMISS FOR LACK OF JURISDICTION OR FOR EQUITABLE RELIEF AND DENYING CFTC'S MOTION TO STRIKE

STEWART, J.

I. INTRODUCTION

***1** The Commodities Exchange Act (CEA) regulates, among other things, Commodity Pool Operators (CPOs). The Gahma Defendants [FN1] contend that the CFTC lacks jurisdiction to bring claims because it only has jurisdiction to bring civil actions against individuals who actually violate the law. They contend that the CFTC lacks jurisdiction over them because, among other reasons, they are not CPOs under the CFTC's jurisdiction, and therefore, there is no subject matter jurisdiction. The Court finds that the claims are adequate to involve a federal controversy and, therefore, there is subject matter jurisdiction.

FN1. Defendants Gahma Corporation and its principals, Garrett, Andersen and Heninger are herein collectively referred to as the Gahma Defendants.

II. Motion to Dismiss

The Gahma Defendants move to dismiss pursuant to Fed.R.Civ.P. 12. As pointed out by the CFTC, and contrary to local rule, [FN2] the Motion and supporting Memoranda [FN3] do not specify under which subsection they seek dismissal. They did not take the opportunity to clarify the issue in their Reply. [FN4] The Court interprets the Motion as seeking dismissal under subsections 12(b)(1) (lack of subject matter jurisdiction) and 12(b)(6) (failure to state a claim).

FN2. DUCivR 7-1(b)(1) ("all motions must ... cite applicable rules, ... justifying the relief sought").

FN3. Docket Nos. 261 and 262.

FN4. Docket No. 284.

A. Rule 12(b)(1)

The Gahma Defendants contend that unless a defendant has actually violated the CEA, the CFTC may not bring an action for civil penalties. They contend that absent such an actual violation, the CFTC may only obtain injunctive relief. [FN5] They contend that the CFTC does not have jurisdiction over them unless (1) commodities were actually traded on Gahma's account; (2) its principals were CPOs; [FN6] or (3) the Gahma Defendants otherwise violated the CEA. They contend that it is undisputed that there was no actual commodities trading on Ghama's account and that fact, combined with the fact that they did not pro rate losses among investors, means that they do not fall within the statutory definition of CPOs. They contend that because they are not CPOs, the CFTC lacks jurisdiction and this case must be dismissed.

FN5. The Gahma Defendants do not challenge the jurisdiction for the CFTC to obtain injunctive relief.

FN6. 7 U.S.C. § 1a(4).

The Gahma Defendants contend that the jurisdictional statute at issue is:

(d) Civil penalties

(1) in any action brought under the section, the Commission may seek and the court shall have jurisdiction to impose, *on a proper showing,* on any person found in the action to have committed any violation a civil penalty in the court of not more than the higher of $100,000 or triple the monetary gain to the person for each violation. [FN7]

FN7. 7 U.S.C. § 13a-1(d) (emphasis added).

The Gahma Defendants are arguing that the statute should be read as providing that the CFTC does not have standing to bring an action for civil penalty unless the "proper showing" is made that they are CPOs or have actually violated the statute. If, as the Gahma Defendants argue, the CFTC lacks standing to bring a claim for civil penalties, the Court would lack subject matter jurisdiction over the case.

The CFTC contends that it has jurisdiction under section 2(a)(1)(A) of the CEA, that it has alleged, and the Gahma Defendants' own materials show, that they are CPOs. Finally, the CFTC contends that there is jurisdiction even if there were no trades on the Gahma account and the Gahma Defendants are not CPOs, because it alleges a violation of a section 6b(a)(a), [FN8] which prohibits fraud in connection with commodity futures transactions by any person regardless of whether their status as CPOs.

FN8. 7 U.S.C. § 6b(a)(i)(ii) and (iii).

***2** In the *Steel Company* case, [FN9] the Supreme Court explained that the existence of a dispute over the interpretation of a federal statute or a dispute over the existence of the violation of that statute does not deprive a federal court of subject matter jurisdiction:

FN9. *Steel Co. v. Citizens for a Better Environment,* 523 U.S. 83, 91-92, 118 S.Ct. 1003, 140 L.Ed.2d 210 (1998) (finding jurisdiction under Emergency Planning and Community Right to Know Act of 1986) (EPCRA)).

It is firmly established in our cases that the absence of a valid (as opposed to arguable) cause of action does not implicate subject-matter jurisdiction, *i.e.,* the courts' statutory or constitutional *power* to adjudicate the case.... As we stated in *Bell v. Hood,* "jurisdiction ... is not defeated ... by the possibility that the averments might fail to state a cause of action on which petitioners could actually recover." Rather, the district court has jurisdiction if "the right of the petitioners to recover under their complaint will be sustained if the Constitution and laws of the

United States are given one construction and will be defeated if they are given another," unless the claim "clearly appears to be immaterial and made solely for the purpose of obtaining jurisdiction or where such a claim is wholly insubstantial and frivolous." Dismissal for lack of subject-matter jurisdiction because of the inadequacy of the federal claim is proper only when the claim is so insubstantial, implausible, foreclosed by prior decisions of this Court, or otherwise completely devoid of merit as not to involve a federal controversy. Here, respondent wins under one construction of [the federal statute] and loses under another ... [FN10]

FN10. *Id.* 523 U.S. at 91-92 (1998) (quoting *Bell v. Hood,* 327 U.S. 678, 682, 66 S.Ct. 773, 90 L.Ed. 939 (1946)), (other internal quotations and citations omitted).

The Gahma Defendants would have to show that the CFTC's claims are "so insubstantial, implausible, foreclosed by prior decisions of this Court, or otherwise completely devoid of merit as not to involve a federal controversy" in order to show a lack of subject matter jurisdiction.

As a general rule, Rule 12(b)(1) motions to dismiss for lack of jurisdiction take one of two forms: (1) facial attacks; and (2) factual attacks. Under a facial attack, the movant merely challenges the sufficiency of the complaint, requiring the district court to accept the allegations in the complaint as true. In a factual attack such as we have here, however, the movant goes beyond the allegations in the complaint and challenges the facts upon which subject matter jurisdiction depends. In such a situation, the court must look beyond the complaint and has wide discretion to allow documentary and even testimonial evidence under Rule 12(b)(1). However, "a court is required to convert a Rule 12(b)(1) motion to dismiss into a Rule 12(b)(6) motion or a Rule 56 summary judgment motion when resolution of the jurisdictional question is intertwined with the merits of the case." "[T]he underlying issue [in determining whether the jurisdictional question is intertwined with the merits] is whether resolution of the jurisdictional question requires resolution of an aspect of the substantive claim." [FN11]

FN11. *Paper, Allied-Industrial, Chemical And Energy Workers Intern. Union v. Continental Carbon Co.,* 428 F.3d 1285, *1292 (10th 2005).

In the present case, because of the way that the Gahma Defendants have framed the issue, the resolution of the jurisdictional issue is not intertwined with the merits of the case. The question instead is whether the claims are so completely devoid of merit as to not involve a federal controversy-a standard akin to the Rule 12(b)(6) standard.

***3** The Gahma Defendants contend that the CFTC cannot proceed under the statute because it admits in the Complaint that there were no actual trades on Gahma's account and also they were not CPOs because the investments they sold did not allocate profits and losses pro rata. Instead, they argue that the investments were promissory notes with fixed, but amazingly high rates of return.

The CEA defines a CPO as:

any person engaged in a business that is of the nature of an investment trust, syndicated, or similar form of enterprise, and who, in connection therewith, solicits, accepts or receives from others, funds, securities or property, either directly or through capital contributions, the sale of stock or other forms of securities or otherwise, for the purpose of trading any commodity for future delivery.... [FN12]

FN12. 7 U.S.C. § 1a(4).

The Court finds that it is not necessary to allege that there were actual trades on the Gahma account for the CFTC to state a valid claim for civil penalties. In *CFTC v. Weinberg,* [FN13] the CFTC recovered civil penalties against an advisor who solicited and received investments for the purpose of making trades in commodities, but never actually made such trades and instead operated as a *Ponzi* [FN14] scheme. [FN15] The Gahma Defendants'

attempt to distinguish the facts of *Weinberg* on the grounds that the defendant in *Weinberg* defaulted is unavailing because the *Weinberg* court's detailed findings of facts are very similar to the facts alleged to have occurred in the present case, down to the guaranteed "profits" on non-existent trades. It would be odd, indeed, if liability under the CEA were totally excused any time that funds invested for the purpose of investing in commodity pools were 100% successfully diverted away from actual trades instead of only a lesser percentage of the total investor funds being so diverted. [FN16] Such a construction would have the anomalous result of encouraging total fraud.

FN13. 287 F.Suppp.2d 1100 (C.D.Ca.2003).

FN14. *See U.S. v. Shelton,* 669 F.2d 446, 450 (7th Cir.1982) (explaining origin of term "Ponzi scheme").

FN15. *Weinberg,* 287 F.Supp.2d at 1103-04.

FN16. *E.g. CFTC v. Skorupskas,* 605 F.Supp. 923, 931-32 and 943-44 (E.D.Mich.1985) (imposing civil remedies of disgorgement and restitution where the broker operating a CPO as a Ponzi scheme deposited only $959,943 of the total $2,672,583 in investments in trading accounts).

As noted, the Gahma Defendants contend that they cannot be CPOs because their investments were promissory notes with a fixed rate of return and the investment they solicited did not allocate profits and losses pro rata. In support they cite *Lopez v. Dean Whittier Reynolds.* [FN17] In *Lopez,* the Ninth Circuit held that the following four factors were required to be present in a commodity pool.

FN17. **805 F.2d 880 (9th Cir.**1986).

(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. [FN18]

FN18. ***Id.* at 884** (italics in original).

Lopez is not controlling on the jurisdictional issue for several reasons. First, in accordance with the rule reiterated in *Steel Company,* the district court in *Lopez* exercised its subject matter jurisdiction to adjudicate the valid, but ultimately unsuccessful claim, that the accounts were commodity pools subject to the CEA. [FN19] Second, the finding in *Lopez* turned on the fact that the plaintiff's investment was treated individually, rather than part of a common pool when it was traded. [FN20] It was that factor, that "common funds" were not "used to execute trades on behalf of the *entire* account," [FN21] that was dispositive and resulted in the lack of pro rata treatment of profits and losses. This lack of mingling the funds for a common treatment is not the situation alleged in the present case by any party. Third, *Lopez* is not controlling authority and has not been widely followed. [FN22] Its adoption of four requirements for a commodity pool is not controlling on the issue of whether a person is a "commodity pool operator," a defined statutory term that does not require the existence of a legitimate commodity pool, only that the person be engaged in a business "in the nature of an investment trust" or similar form of enterprise who, in connection with that business solicits, accepts or receives from others, funds in any of the various enumerated forms "for the purpose of trading in a commodity ." [FN23] Fourth, the CFTC in the present case has alleged pro rata distribution of profits and losses and supports that position with a Declaration. The fact that the Gahma Defendants termed the investments they sold as promissory notes does not control, it is the substance that controls and that will be determined at trial. What is at issue at the present time is only whether the claim that Gahma

Defendants were CPOs who violated the CEA is so completely devoid of merit as to not involve a federal controversy and deprive the Court of subject matter jurisdiction.

FN19. ***Id.* at 882 and 884** (affirming district court's holding that account was not a commodity pool and therefore there was no violation of the CEA).

FN20. ***Id.* at 882 n. 2 and 884** (there as a disparity in investment in the individual accounts and not all accounts traded the same contracts).

FN21. 7 U.S.C. § 1a(4) quoted more fully *supra.*

FN22. The citation to the four requirements as a profile of the operation of a commodity pool in *Nicholas v. Saul Stone & Company,* 224 F.3d 179, 181 n. 4 (3rd Cir.2000) is dicta.

FN23. 7 U.S.C. § 1a(4).

***4** The Court finds that the CFTC's claims are not so completely devoid of merit that it has no standing. This is especially true where the CFTC brings claims against the Gahma Defendants alleging violation of Section 6b(a), [FN24] which prohibits fraud in connection with commodity futures transactions by any person regardless of their status as CPOs.

FN24. 7 U.S.C. § 6b(a)(i)(ii) and (iii).

The Gahma Defendants also contend that under section 2(i)(I), [FN25] that the SEC or the state regulatory agencies retain jurisdiction unless the case involves contract of sale of commodities for future delivery that are *actually* traded or executed on a contract market. The CFTC contends that it does have enforcement jurisdiction under that section of the CEA. The Court agrees with the CFTC that it has comprehensive, but not necessarily exclusive, jurisdiction in this area. [FN26]

FN25. 7 U.S.C. § 2(a)(1).

FN26. *See SEC v. Unique Finance,* 196 F.3d 1195 (11th Cir.1995) ("Commodity *pools* ... are within the concurrent jurisdiction of the CFTC and the SEC.") (italics in original).

Based on the foregoing, the Court finds that is has subject matter jurisdiction over the valid, but hotly disputed, claims. The Court denies the Gahma Defendants' Motion to Dismiss for lack of subject matter jurisdiction.

B. Rule 12(b)(6)

In considering a motion to dismiss under Rule 12(b)(6), all well-pleaded factual allegations, as distinguished from conclusory allegations, are accepted as true and viewed in the light most favorable to the CFTC as the nonmoving party. [FN27] A Rule 12(b)(6) motion to dismiss may be granted only if it appears beyond a doubt that the plaintiff is unable to prove any set of facts entitling it to relief under its theory of recovery. [FN28] All well-pleaded factual allegations in the amended complaint are accepted as true and viewed in the light most favorable to the nonmoving party. [FN29] But, the Court "need not accept conclusory allegations without supporting factual averments." [FN30] "The Court's function on a Rule 12(b)(6) motion is not to weigh potential evidence that the parties might present at trial, but to assess whether the plaintiff's complaint alone is legally sufficient to state a claim for which relief may be granted." [FN31]

FN27. *Ruiz v. McDonnell,* 299 F.3d 1173, 1181 (10th Cir.2002).

FN28. *Conley v. Gibson,* 355 U.S. 41, 45-46, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957).

FN29. *GFF Corp. v. Associated Wholesale Grocers, Inc.,* 130 F.3d 1381, 1384 (10th Cir.1997).

FN30. *Southern Disposal, Inc., v. Texas*

Waste, 161 F.3d 1259, 1262 (10th Cir.1998); *Hall v. Bellmon,* 935 F.2d 1106, 1110 (10th Cir.1991).

FN31. *Miller v. Glanz,* 948 F.2d 1562, 1565 (10th Cir.1991).

Having reviewed the Complaint, the Court finds that the CFTC states claims against the Gahma Defendants sufficient to overcome the Rule 12(b)(6) standard. Therefore, the Court will deny the Motion.

III. Motion for Equitable Relief

The Gahma Defendants seek an order "properly" defining the CFTC's burden of proof and holding a hearing to determine whether the CFTC can make a prima facie case against them for violating the CEA. [FN32] It is clear from their Memoranda and Reply that what the Gahma Defendants are requesting via this unusual Motion is an advisory opinion on whether the Court will adopt their theory of calculating damages for the purpose of resolving an apparent disagreement between the parties as to the Gahma Defendants' "civil exposure" in their settlement negotiations.

FN32. Defs' Mot. at 28; see also Reply at 4 (requesting Court to "properly" the CFTC's burden of proof and the Gahma principals' civil exposure").

The Court will not issue such an advisory opinion. Further, insofar as the Gahma Defendants seek a determination of the sufficiency of the CFTC's prima facie case, it was available to them at any time by filing a Motion for Summary Judgment and pointing out the alleged lack of evidence on any essential element of any claim. [FN33] Accordingly, the Court denies the Motion for Equitable Relief. The Court will not substitute equitable hearings for the procedures established by the Federal Rules of Civil Procedure.

FN33. See *Adler v. Wal-Mart Stores, Inc.,* 144 F.3d 664, 670-71 (10th Cir.1998) (a movant that will not bear the burden of persuasion at trial may meet its initial burden of making a prima facie demonstration of the absence of a genuine issue of material fact and entitlement to judgment as a matter of law "simply by pointing out to the court a lack of evidence for the nonmovant on an essential element of the nonmovant's claim").

IV. Conclusion and Order

***5** The Gahma Defendants did not respond to the CFTC's Motion to Strike certain paragraphs of their statement of undisputed facts. Because the Gahma Defendants' Motion to Dismiss is denied, the Motion to Strike is moot. For the foregoing reasons, it is therefore

ORDERED that Gahma Defendant's Motion to Dismiss or for Equitable Relief (Docket No. 261) is DENIED. It is further

ORDERED that CFTC's Motion to Strike Certain Paragraphs of Defendants' Statement of Undisputed Facts (Docket no. 275) is DENIED AS MOOT.

Slip Copy, 2006 WL 223835 (D.Utah)

Motions, Pleadings and Filings (Back to top)

• 2005 WL 3197911 (Trial Motion, Memorandum and Affidavit) Plaintiff Commodity Futures Trading Commission's Memorandum of Law in Opposition to Defendant Carol J. Love's Motion for Summary Judgment and Cross Motion for Summary Judgment in Plaintiff's Favor (Nov. 07, 2005)

• 2:00cv00622 (Docket) (Aug. 08, 2000)

END OF DOCUMENT

CERTIFICATE OF SERVICE

The undersigned non-attorney, Anne Smith, does hereby certify that on April 20, 2006 she caused a true and correct copy of the foregoing ***CFTC'S RESPONSE TO ROBERT W. SHIMER AND VINCENT J. FIRTH'S SECOND MOTION FOR SUMMARY JUDGEMENT*** to be served upon the following persons via electronic mail and first class mail.

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