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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 MEMORANDUM IN SUPPORT OF MOTION FOR PARTIAL SUMMARY JUDGEMENT AGAINST DEFENDANTS EQUITY FINANCIAL GROUP LLC, ROBERT. W. SHIMER AND VINCENT J. FIRTH

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Plaintiff Commodity Futures Trading Commission ("the Commission" or "CFTC") moves for summary judgment against Defendants Equity Financial Group, LLC ("Equity"), Robert W. Shimer ("Shimer") and Vincent J. Firth ("Firth") on charges that they violated §§4k(2), 4m and 4*o*(1) of the Commodity Exchange Act ("the Act"),7 U.S.C. §§ 6k(2), 6m and 6*o*(1) (2002). The Commission also moves for summary judgment on its charge that Shimer aided and abetted Equity's 4m violation and Tech Traders[1]' violation of Regulation 4.30, 17 C.F.R. § 4.30 (2005).[2] Pursuant to Rule 56 of the Federal Rules of Civil Procedure, the pleadings, depositions, documents produced in discovery, admissions and declarations filed with the Memorandum show that there is no genuine issue of material fact on these charges and that the Commission is entitled to summary judgment as a matter of law.[3]

I. SUMMARY JUDGMENT STANDARD

The standard for considering a motion for summary judgment is clear. Summary judgment is proper "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c); *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 452 (3rd Cir. 1997). An issue is "genuine" "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S.Ct. 2505

[1] The Commission's First Amended Complaint alleges that defendants Tech Traders, Inc., Tech Traders, Ltd., Magnum Investments, Ltd. and Magnum Capital Investments, Ltd. are a common enterprise controlled by the same persons. First Amended Complaint at ¶ 1c. They are thereafter collectively referred to as "Tech Traders" and will also be so referred to in this memorandum.

[2] If summary judgment is granted on these charges, the only remaining charge against these defendants will be a fraud charge under Section 4b of the Act, 7 U.S.C. §6b.

[3] The evidence is summarized 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 , which will be referred to throughout this Memorandum as "SMF".

(1986). A fact is "material" if it may affect the outcome of the suit under the applicable law. *Id.* .

The moving party always "bears the initial responsibility of informing the district court of the basis for its motion, and identifying those portions of the 'pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any,' which it believes demonstrate the absence of a genuine issue of material fact." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 106 S.Ct. 2548 (1986). However, where the nonmoving party bears the burden of persuasion at trial, "the burden on the moving party may be discharged by 'showing' – that is, pointing out to the district court-that there is an absence of evidence to support the nonmoving party's case." *Id.* at 325. The non-moving party "may not rest upon the mere allegations or denials of" its pleadings and must present more than just "bare assertions, conclusory allegations or suspicions" to establish the existence of a genuine issue of material of fact. Instead, the non-moving party "must make a showing sufficient to establish the existence of every element essential to his case, based on the affidavits or by the depositions and admissions on file." *Harter v. GAF Corp.,* 967 F.2d 846, 852 (3d Cir.1992); *Pastore v. Bell Telephone Co. of Pennsylvania,* 24 F.3d 508, 511 (3d Cir.1994). Fed.R.Civ.P. 56(e); *Jalil v. Avdel Corp.*, 873 F.2d 701, 707 (3d Cir.1989) (citation omitted). "A party's failure to make a showing that is 'sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial' mandates the entry of summary judgment." *Watson v. Eastman Kodak Co.*, 235 F.3d 851, 857-858 (3d Cir. 2000) (quoting *Celotex*, 477 U.S. at 322).

II. FACTS FOR WHICH THERE IS NO GENUINE DISPUTE

A. The Parties and Overview of the Fraud

Equity is a New Jersey limited liability corporation that has never been registered with the CFTC in any capacity. [SMF at ¶¶ 2, 3] It was the manager of Shasta Capital Associates, a Delaware limited liability company. [SMF at ¶ 2.] Firth is the President, sole shareholder and a controlling person of Equity. [SMF at ¶¶ 4, 10.] Shimer was legal counsel to Equity and Shasta and, as shown below, was also a controlling person of Equity. [SMF at ¶ 5.] Neither Firth nor Shimer is registered as an associated person ("AP") of Equity, although Shimer was registered as an AP of a commodity pool operator ("CPO") in 1986 and an AP of an introducing broker ("IB") in 1989. [SMF at ¶¶ 11, 13.] He took and passed the Series 3 examination required for APs in the futures industry in 1986. [SMF at ¶ 13.] He is also an attorney and has been a member of the Massachusetts Bar since 1973. [SMF at ¶ 13.]

Shasta was a feeder fund to the Tech Traders' "super fund" master pool. [SMF at ¶ 8.] Defendant Coyt Murray ("Murray") was the president and CEO of Tech Traders and was Tech Traders' primary contact person in dealing with potential participants. [SMF at ¶ 6.] During the time relevant to this First Amended Complaint, Murray and Tech Traders operated out of an office in Gastonia, North Carolina. [SMF at ¶ 6.] Murray represented to Firth and Shimer that Tech Traders used a unique, self-developed "portfolio" system for successful trading of selected exchange-traded financial futures contracts, including the NASDAQ 100 and S&P 500. He told Firth and Shimer that the success of the portfolio system derived from the fact that it utilized many different, allegedly non-correlated, separate systems traded concurrently on different time frames using proprietary algorithms, which not only helped filter out market noise for the purpose of more correctly determining the real

direction of market trends, but also would balance and smooth the performance of the system. [SMF at ¶ 6.]

Murray and Tech Traders hired Defendant J. Vernon Abernethy ("Abernethy") to review and verify Tech Traders' trading results and supply a monthly trading performance number to third parties such as Equity and Shasta. [SMF at ¶ 63.] Abernethy produced a combination of monthly and quarterly reports, called Agreed Upon Procedures ("AUP") reports, covering Tech Traders' trading performance from June 2001 through February 2004. [SMF at ¶¶ 64, 66.] These AUPs showed gains for every month or quarter reported on from June 2001 through February 2004. Abernethy reported double-digit gains for at least 23 of the 33 months during this period. The worst performance reported was a purported gain of 4.11% for the month of June 2001, and the next worst performance reported was a purported gain of 9.02% for the month of January 2004. [SMF at ¶ 69.]

Shimer drafted a Private Placement Memorandum ("PPM"), which was reviewed and approved by Firth. [SMF at ¶ 34.] Equity solicited interest in Shasta by various means, including individual solicitations by Shimer and Firth, distribution of the PPM, operation of a website, http://www.shastacapitalassociates.com/, and provision of information to third parties that tout hedge funds to investors on various web sites, including http://www.hedgeco.net/, http://www.barclaygrp.com/ , and http://www.hedgefundresearch.com/. [SMF at ¶ 34.] The performance figures reported on Equity's web site were identical to those in the agreed upon procedures reports prepared by Abernethy. As of March 2004, the web site reported purported returns totaling over 130% for the period March 2003 to February 2004. [SMF at ¶ 34 .]

Between at least June 2001 and April 1, 2004, Equity, Shimer and Firth solicited and received $14,616,498.11 from 65 investors for participation interests in Shasta and transmitted most or all of those funds to Tech Traders. In total, Tech Traders received a total of approximately $43.1 million from Shasta and other investors. At the time Tech Traders' assets were frozen by the Court, Tech Traders, Inc. had returned a total of $11.3 million of principal to investors, paid approximately $638,000 in fictitious profits to investors, transferred $2.4 million to its predecessor entity Magnum Investments, Ltd., used nearly $2 million for operating expenses, and transferred nearly $2.2 million to Equity and other entities controlled by Robert Shimer or Vincent Firth. In order to make its investors whole, the receivership estate of Tech Traders, Inc. would need approximately another $15 million plus costs of administration. [SMF at ¶¶ 33, 8.]

B. Shimer and Firth Had Checkered Past Investment and Business Experiences

Before creating Shasta and soliciting nearly $15 million from 65 investors, Shimer and Firth participated in numerous failed business dealings in which people they had solicited for investments had lost money. They failed to disclose these past business failures and resulting debts to actual and prospective investors in Shasta. [SMF at¶¶ 33, 15-21.]

In the late 1990's, Firth had introduced several parties to an entity known as Badische Trust ("Badische") to secure financing. Badische allegedly absconded with the parties' commitment fees. At least two parties that Firth introduced to Badische brought legal action against Firth and secured judgments or other relief against Firth. [SMF at ¶ 15.] Firth and his wife have also twice filed for bankruptcy under Chapter 13 of the Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.* (2003), in October 2000 and February 2003, and also for discharge under Chapter 7 of the Code in 1992. [SMF at ¶ 12.]

Shimer also had been involved in several failed investments – in which investors lost

over $1 million. In 1998, Shimer was involved in the formation of Kaivalya, a Nevada corporation. Through Kaivalya, Shimer and others collected money from investors for three different investments. [SMF at ¶¶ 17-19.] Each of these investments was a dismal failure and the investors Shimer and his associates had attracted to them did not recover their principal investment. [SMF at ¶¶ 17-20.]

The first Kaivalya investment dated to February 1999, when Shimer and others collected a total of $669,000 for investment in a certificate of deposit ("CD") offered by a third party that was supposed to provide a 9% return per month. The CD paid interest for about a year and then defaulted. The investors did not recover their principal. [SMF at ¶17.]

Two months later, in April 1999, Shimer and his Kaivalya associates collected $325,000 from investors for an investment involving Treasury bills, paid an associate named Laurie Scott $75,000 of that and wired the remaining $250,000 to the escrow account of an attorney for the T bill promoter, Cimini. Kaivalya issued promissory notes to investors promising interest rates of 50-100% a month. This investment turned out to be an international scam and involved a government investigation. None of the $325,000 was ever recovered. [SMF at ¶ 18.]

The third Kaivalya investment was made through Jerry LaTulippe ("LaTulippe") and Tom Leonard ("Leonard"). Shimer had met LaTulippe on a flight to Grenada and was impressed with him. LaTulippe told him that he had an exclusive relationship with a trader who was obtaining phenomenal results trading the markets. That trader was Coyt Murray. Shimer did not know what markets the trader was trading. Nonetheless, he invested $100,000 in early September 1999. In October, he flew to the Bahamas to visit a trading platform owned by Hubert Pinder. There he met Coyt Murray. Murray told him he had

licensed his trading system to Pinder. After this meeting in the Bahamas, Shimer collected over $1,300,000 from investors and wired the money to an account in the name of Good Works, which he was told was a company controlled by LaTulippe. Shimer drafted promissory notes to investors providing for at least a return of principal and a possible 25% return starting in 90 days. [SMF at ¶ 19.]

This third Kaivalya investment also failed. LaTulippe and Leonard did not pay back the principal in 90 days. Over the course of the next year, Shimer received a series of excuses about what had happened to the Kaivalya investors' money. He also agreed to give LaTulippe and Leonard more investor money in a vain attempt to persuade them to return the $1.3 million they had taken. Shimer began to receive pressure from some of the Kaivalya investors who had invested in one or more of the three failed deals and who wanted their money back. These investors threatened him with lawsuits or exposure to governmental authorities. [SMF at ¶¶ 20-21.] Shimer therefore decided to try to find the trader LaTulippe and Leonard had claimed to give the $1.3 million to – Coyt Murray. [SMF at ¶ 22.]

C. The Development of Shasta

In the fall of 2000, Shimer tracked down Coyt Murray in Gastonia, North Carolina. Murray told Shimer inconsistent stories about his previous trading experience. Although when Shimer met him in the Bahamas, Murray had told him he had licensed his system to Pinder, in the fall 2000 meeting, he told Shimer that he had been back-testing his trading system for a year and was just beginning to trade. At various points in the relationship, Murray also told Shimer that he had returned money Pinder had given him to trade because a) his lawyers told him to because Pinder was misusing investor funds, or b) he had lost money trading due to a power outage. Despite these inconsistencies, Shimer did not ask Murray a lot of questions about his past experience with LaTulippe, Leonard and Pinder.

[SMF at ¶ 22.]

Murray told Shimer that he had never received the $1.3 million Shimer had sent to LaTulippe to place with Murray's trading system. Nonetheless, Murray agreed to help Shimer repay the Kaivalya investors. [SMF at ¶ 22.] The two therefore devised a plan to accomplish this. Shimer agreed to attract investors to invest in Murray's trading system and Murray agreed to secretly split the "profits" obtained through that trading with Shimer and Firth. [SMF at ¶ 24.] This secret split of the profits would be used primarily to repay the Kaivalya investors, but it was also used to pay a mortgage for Firth and for Shimer to give $82,000 to a former Kaivalya associate and principal of Universe[4], David Perkins. [SMF at ¶ 25.]

Shimer later drafted the documents to memorialize this secret profit split. Thus, in Shasta's PPM, after an initial 1 or 2% preferential rate of return to Shasta investors, Tech Traders was entitled to 15% of the "profits" from trading for trading and operational expenses and 50% of any remaining "profits". From the 50% of "profits" allocated to Shasta investors, 5% stayed with Equity as a management fee. However, Shimer drafted another agreement that neither he nor Firth disclosed to investors. This secret agreement between Tech Traders Ltd. and Shadetree, a Nevis trust, provided that Tech Traders would allocate a third of the Tech Traders' 15% "profit" share to Shadetree and half of its 50% share of any remaining "profits" to Shadetree. [SMF at ¶¶ 28, 29.] Although Tech Traders ostensibly entered into the agreement with Shadetree and Tech Traders set up an internal account for Shadetree, no payments under the agreement ever went to an account in the name of

[4] Universe was a limited liability corporation formed to invest in Shasta. It had 40 investors who collectively invest $3.4 million in Shasta. [SMF at ¶ 25.]

Shadetree. Instead, payments of $1,314,930 were made pursuant to Shimer's direction to a bank account in the name of Kaivalya that was under the control of Shimer. [SMF at ¶ 30.] This agreement for a further profit split, and the millions paid to Shimer under it, were not disclosed in the Shasta PPM and were not otherwise disclosed to Shasta investors or potential investors. [SMF at ¶29.]

Sometime after his first meeting with Murray, Shimer brought in Firth to work on formulating an investment vehicle to invest in Tech Traders. He had met Firth through LaTulippe in the fall of 1999 when Shimer was introduced to Firth as LaTulippe's lawyer. Firth was told that Shimer was representing LaTulippe in seeking to invest funds in some real estate projects. [SMF at ¶ 26.] Shimer brought Firth to meet Murray and Murray described his trading system to both of them. After initial meetings however, Firth had very few interactions with Murray. Murray preferred to deal with Shimer. [SMF at ¶¶ 57, 58.]

As Shimer began soliciting potential investors for Murray's trading system, he learned there was information about the trading system that Murray did not want to reveal. In February 2001, Shimer brought David Kaplan, the developer of a condominium Shimer owned with his wife, to meet Murray. Kaplan was a sophisticated investor who had millions to invest. He asked Murray how much money his company had in trade, how much he had made in profits and through which futures commission merchant ("FCM") he traded. Shimer noticed how uncomfortable Murray was with these questions. In a subsequent letter to Murray, Shimer noted an inherent conflict between Murray's need to maintain his financial privacy and an investor's need to receive information. Murray did not want to tell anyone

how much money he had in trade and he repeatedly told Shimer that throughout their relationship. [SMF at ¶¶ 47, 48.]

Kaplan had been willing to let Murray trade his money pursuant to a power of attorney in a trading account in Kaplan's name. Other potential investors also expressed an interest in letting Murray trade their funds in accounts in their names. However, Murray was not willing to trade his phenomenal system that way. Murray told Shimer he had to have control of the funds because he was concerned that if an investor saw trading account statements, the investor could "reverse engineer" his system. [SMF at ¶ 49.]

After this meeting with Kaplan, Shimer began to develop an investment structure to deal with Murray's idiosyncratic concerns. He told Murray that it was his job to build a "ring of legal protection" between Murray and potential investors while still honoring each investor's legitimate desire for some type of independent verification of Tech Trader's performance each month. Shimer told Murray he had just the right person to do it – a CPA partner in a small accounting firm in Portland, Oregon that had been a "dear friend" for 20 years – Elaine Teague. In addition to being a good friend, Shimer found her to be an honest person. Shimer chose Teague over larger, more established CPA firms because he knew a larger, more established firm may not want to take on the engagement [SMF at ¶¶ 50, 60.]

During the spring of 2001, Shimer and Firth set about creating two investment vehicles to attract investor funds to Tech Traders. The first vehicle was New Century Trading LLC ("New Century"), a Nevis, West Indies limited liability company formed in April 2001 for foreign investors to invest in Tech Traders. Its manager was Allied International Management, Ltd. [SMF at ¶ 55.] Later, in June 2001, a domestic entity, Shasta, was formed. The manager of Shasta became Equity, a limited liability corporation

formed earlier by Firth for a real estate project, of which Firth was president. The Shasta PPM was designed to meet Murray's desire for privacy while providing comfort to investors that the trading results were legitimate. It provides that all invested funds will be traded in the name of the trader but does not disclose the name of the trader. It also provides for independent verification of the trader's trading results through two undisclosed CPAs. [SMF at ¶¶ 2, 51.]

D. The Independent CPA Verification

Shimer controlled the development of the independent CPA verification process. From the beginning, he designed a faulty process. He also ignored indications throughout the time period relevant to this case that the verification was suspect. [SMF at ¶¶ 64, 65, 69, 74-81.]

Shimer initially selected Teague to perform the verification process, although she did not have any experience in performing rate of return calculations for an investment vehicle. [SMF at ¶ 61.] Shimer also defined the way to calculate profits based on a review of Tech Traders' brokerage statements[5], although he had no experience in performing rate of return calculations either. [SMF at ¶¶ 61, 76.] Shimer believed this calculation, which involved subtracting the beginning balance from the ending balance and dividing the difference by the beginning balance, was something so simple any 6th grader could perform the calculation. He defined profit in this way in the Investment Agreement between Shasta and Tech Traders. [SMF at ¶ 76.] However, Teague gave him information that should have caused him to

[5] During the time it accepted Shasta funds, Tech Traders traded commodity futures contracts through multiple trading accounts at four futures commission merchants ("FCMs"). [McCormack Declaration at ¶ 7.] Because the account statements that Tech Traders received from the FCMs are almost always referred to in the testimony and the exhibits as "brokerage" statements they will hereinafter be referred to as brokerage statements in the Memorandum.

question his "simple" calculation. In the first PPM it was contemplated that Shasta would invest in both Tech Traders and established hedge funds, four out of five of which were commodity pools who's CPOs were properly registered with the CFTC. Teague reviewed the disclosure documents of these funds and learned that they all used different, more complex methods of determining rate of return. When she pointed this out to Shimer, he ignored her questions about how Tech Traders was calculating performance and told her that Abernethy was using a simpler method that Shimer had devised. [SMF at ¶ 76.]

Murray rejected Shimer's suggestion that Teague perform the verification of returns. She had wanted to see original brokerage statements and bank statements but Murray did not want original brokerage statements sent to her; he wanted the statements reviewed in his office. Although it would have been a simple matter to send duplicate statements to her, sending such statements was not considered as an option. Instead, Murray hired his own accountant to perform the task. [SMF at ¶ 64.]

Murray's longtime accountant, Robert Collis, declined the engagement. [SMF at ¶ 65.] Murray then selected a local CPA who had an office in the same complex as Tech Trader's – J. Vernon Abernethy. [SMF at ¶ 65.] Shimer met Abernethy shortly after he was selected in July 2001. He told Teague he was impressed with Abernethy and that he had the right credentials for the job. [SMF at ¶ 74.] However, there were red flags from the beginning about Abernethy's suitability to perform an independent verification of Tech Traders' returns. At the time, Abernethy was in the process of moving out of his office because of a divorce from his wife and partner in their CPA practice. Murray told Shimer that Abernethy was having financial difficulties and suggested to Shimer that Shimer and Firth let Abernethy make extra money by soliciting for Tech Traders, even though Abernethy

was supposed to be an independent accountant. [SMF at ¶ 75.] Shimer and Firth did allow Abernethy to solicit for the Shasta pool for a time, shattering the independence he was supposed to have and which the Shasta PPM represented him to have. [SMF at ¶ 75.]

Pursuant to the engagement, Abernethy was supposed to verify Tech Traders' trading results through a set of AUPs. These procedures were described in a letter that he sent each month to Murray ("AUP letter"). Each letter gave a monthly, and sometimes quarterly, return number. [SMF at ¶ 66.]

These AUPs were faulty. Shimer did not understand them. [SMF at ¶ 69.] Among other issues, Abernethy, claiming to use the formula for determining profit that was written into the contract between Shasta and Tech Traders by Shimer, often did not account for either additions or withdrawals to Tech Traders' brokerage or bank accounts, thus skewing his calculation into one that reflected cash flow instead of rates of return. This caused Abernethy to report a positive rate of return so long as new deposits into the brokerage accounts exceeded withdrawals and trading losses. [SMF at ¶ 69.]

Neither Firth, Shimer nor Teague specifically knew what documents and figures Abernethy was reviewing to arrive at the rates of return he reported. [SMF at ¶ 70.] Teague tried to learn what Abernethy was reviewing, but Shimer intervened, keeping the process a secret. Teague expected to receive a report of trading performance created by Murray along with Abernethy's AUP letter. Shimer told her she would not receive it because Murray had told Shimer the report contained information about funds other than Shasta's to which he did not want Teague to have access. Shimer knew that Teague did not know what Murray was giving Abernethy to review to determine a rate of return number and he never asked Murray either. [SMF at ¶ 80.]

Because of Murray's "idiosyncrasies", Shimer and Firth shielded the names of Tech Trader and Abernethy from investors. Thus, investors could not independently investigate either the trader who was actually doing the trading or the CPA who was supposed to be reviewing the records to assure that profits were actually being made. [SMF ¶¶ 40, 128.]

In order to address investor concerns about profitability, Shimer created a procedure though which Teague would receive verification of Tech Trader's trading results and pass them along to Equity. Teague performed no independent review of the trading results. Nevertheless, Shimer and Firth made her available to answer investor questions. She was allowed to confirm the performance number each month, but she was not allowed to give investors the name of either Tech Traders or Abernethy. [SMF at ¶ 67.]

Teague also sent a verification letter each month to Equity that did nothing more than repeat the performance number Abernethy had reported in his AUP letter. The body of the verification letter was form text that said nothing about what procedures Abernethy was performing to arrive at this number. [SMF ¶ 66.]

The lack of detail was intentional. When Teague sent Shimer a draft letter, Shimer added language which stated that Abernethy was granted full access to the in-house trading records of Tech Traders and was given the opportunity to review original brokerage statements. When Abernethy requested a copy of Teague's draft verification letter to review, Shimer, not Teague, sent it to him. Abernethy crossed out the language in Teague's draft verification letter that stated he was granted full access to trading records and original brokerage statements. He replaced it with vague language which stated that "Shasta has received and accepted as reasonable and reliable for the purpose for which it is to be used the agreed-upon procedures established between Abernethy and Tech Traders". Shimer did not

tell Teague that Abernethy had made those changes to her letter. He also did not object to Abernethy's changes but accepted them all "word-for-word", despite the fact that Abernethy had crossed out language that would indicate he was reviewing original brokerage statements, which the Shasta PPM stated was part of the verification process. [SMF at ¶ 81.]

After Abernethy and Teague were hired, Shimer played a central role in orchestrating the performance verification process. Shimer inserted himself as Teague's main point of contact on the Shasta engagement. During the development of the verification process, Teague had only two phone calls with Abernethy. She spoke to him only two more times in the course of the entire 3 year engagement and never met him. Shimer, on the other hand, had many face-to-face meetings with Abernethy and spoke to him on the telephone frequently. [SMF at ¶¶ 74, 79.] When the process of receiving verified performance numbers bogged down in the summer of 2001, Teague turned to Shimer to get the process moving again. When she had questions about what Abernethy was doing, Shimer answered them. [Id.]

Firth did nothing to assure that the independent CPA verification of returns was properly handled. Although he soon grew uncomfortable with Abernethy and wanted him replaced, he did nothing to initiate such a replacement. He relied entirely on Shimer to handle that process. [SMF at ¶¶ 72, 73.]

E. Shimer Created Tech Trader's Statements to Shasta

In early 2002, Shimer also took over preparing Tech Traders' monthly account statements, or reports, to Shasta because Murray did not issue them on a timely basis. Shimer went back to the beginning of Shasta's relationship with Tech Traders and recomputed the beginning and ending balances of Shasta's account with Tech Traders using Shasta's own information about additions and withdrawals and the "verified" rate of return

number that Abernethy passed along to Teague each month. Shimer continued to perform this function for the life of the relationship with Tech Traders. [SMF at ¶ 82.] At some point, Shimer asked Murray why he did not hire a bookkeeper to issue the statements, particularly as Shasta's funds with Tech Traders' began to grow and consistent double digit returns were earned. Murray never had his own bookkeeper take over this function and Shimer continued to produce Shasta's own account statements. He and Murray also agreed to assume that Shasta's funds began trading 8 days after Shimer sent them to Tech Traders, regardless of whether the funds were actually in Tech Trader's trading accounts at that time. At the end of the month, Shimer would ask Murray how many trading days there had been in the month, then computed the rate of return on the funds based on the assumption that Tech Traders began trading them 8 days after Shimer sent the funds to it. [SMF at ¶¶ 85, 86.]

Shimer knew that Shasta should not be producing its own reports and that it was troublesome that Tech Traders would not do it. He had asked Teague at the beginning of her engagement to perform this task. Teague had told him in July 2001 that that information should come from Tech Traders, not Shasta and not her. Nonetheless Shimer prepared Shasta's own reports, using Shasta's own records, Abernethy's rate of return number and the 8-day fiction for when the funds began trading, sent them to Murray and had Murray send them to Firth. Firth knew that Shimer was preparing Shasta's own reports. Shimer, however, never told Teague that he was preparing Shasta's own reports and actively concealed that information from her. [SMF at ¶¶ 82-84.] Teague, believing the reports were actually being complied by Tech Traders, used the Tech Traders' reports to Shasta as a third party confirmation of Shasta's balances with Tech Traders. [SMF at ¶ 83.]

F. Minimum Account Verification

In addition to verifying Tech Traders' rate of return, Shimer wanted Abernethy to verify that Tech Traders had on deposit with its brokerage firms sufficient funds to cover the amount Shasta and New Century had on deposit with Tech Traders. He wanted Teague to be able to tell investors that Tech Traders had enough on deposit to cover Shasta's deposits to it. He told Teague that he did not need verification of Tech Traders' actual balance, although he was aware that Tech Traders had other investors besides Shasta and New Century which the Shasta PPM did not disclose. [SMF at ¶ 88.]

Teague repeatedly warned Shimer that a mere verification from Abernethy that Tech Traders had an amount on deposit that exceeded Shasta's deposits to Tech Traders did not go far enough, because it did not assure that Tech Traders had enough on deposit to cover all investors' deposits to the super fund. Investors who asked enough questions to find out that there was a "super fund" also were concerned that the minimum account verification did not provide any real comfort to investors. But Shimer knew Murray would not allow verification that Tech Traders had enough funds to cover all investors and he did not press it. [SMF at ¶90, 93.]

As with the verification of the rate of return, Shimer controlled the process of getting this minimum account verification. He was the only person affiliated with Equity that spoke to Abernethy about it – Teague never did. [SMF at ¶ 88.]

There were other red flags surrounding this minimum account verification. Abernethy did not want to provide this balance verification at all and Shimer had to press him to provide it, even though Shimer thought it was a simple task. [SMF at ¶ 91.] Teague also thought a verification of the whole amount should be a simple process for Abernethy.

[SMF at ¶ 90.] When Abernethy did agree to provide some minimal verification of balances, he imposed restrictions that did not make sense. Instead of questioning these restrictions, Shimer acquiesced in them. Thus, when Abernethy told Shimer that he would not verify anything with regard to a foreign company like New Century but would only verify that Tech Traders had enough on deposit to cover Shasta's deposits, Shimer told Teague that was fine as New Century investors would not call and ask her about Tech Traders' balances. [SMF at ¶ 89.]

Shimer also prepared a set of draft form letters for Abernethy and Teague to use in providing and receiving the verification that Tech Traders had sufficient funds to cover its exposure to Shasta. This included a draft letter from Teague to Abernethy and a reply from Abernethy to Teague to verify that the amount of funds Tech Traders held in brokerage accounts exceeded Shasta's and New Century's deposits with Tech Traders. Abernethy refused to use the draft letters and eventually agreed only to add a sentence to his AUP letters quarterly, rather than monthly as Shimer requested, that stated that the amount in Tech Traders' brokerage accounts exceeded a particular amount. Over the course of a year and a half, he produced only 7 AUP letters that added a sentence that stated that Tech Traders held funds in its brokerage accounts that exceeded a certain amount. For 3 of those 7 months, the amounts he verified were **lower** than the amount Shasta's statements reflected Shasta had invested in Tech Traders. [SMF at ¶ 92.] The fact that Abernethy would not state that Shasta had a certain balance with Tech Traders, and the fact that his minimum account verification did not even cover Shasta's deposits nearly half the time, should have been a huge red flag that perhaps, Shasta did not have the balances at Tech Traders that the Shimer-created Shasta

statements said it had. Nonetheless, even after legal counsel with Arnold & Porter[6] told Shimer that Tech Traders looked like a Ponzi scheme because the performance numbers were so good, Shimer continued to accept the restricted information he was receiving. [SMF at ¶¶ 94, 125.]

G. Other Red Flags about Tech Traders' Operations

Shimer encountered other red flags that should have made him question Tech Trader's operations. He knew that Murray needed time to release requested withdrawals. In August 2003, Shimer wired Tech Traders $103,950 of investor money and asked Murray to immediately wire the funds to a Kaivalya bank account Shimer controlled. Firth and Shimer sought the funds to pay an immediate mortgage obligation of Firth's. Although Shimer knew it was improper to use investor money this way, he requested the money be so misused because Murray would not otherwise immediately release Shasta funds already invested with Tech Traders. [SMF at ¶ 97.] In January 2004, Shimer requested a $220,000 withdrawal from Tech Traders' internal Shadetree account. At the time, Shasta, New Century and Shadetree had a combined balance of about $15 million according to the Shimer-created statements from Tech Traders. Nonetheless, Murray balked at the request because he had learned that the CFTC had started an investigation and he was concerned about large withdrawals from his other investors. [SMF at ¶ 98.]

Shimer also knew that Murray was continuing to associate with known con artists. One of these was Chuck Harkey, whom Shimer had met in the Bahamas in 1999 when he first met Murray and saw the trading platform Murray had licensed to Pinder. Murray had

[6] Shasta, through Shimer, hired the law firm Arnold & Porter to review Shasta's registration requirements in October 2003. That representation, and the further red flags it presented Shimer and Firth, are described below.

told Shimer that Harkey was a scam artist who took money from investors and used it for purposes other than what he had told investors he would use it for, but that he considered Harkey a friend. [SMF at ¶ 32.] In February or March 2001, Murray told Shimer that he was still communicating with Leonard and that he was thinking of taking money from Leonard for his trading system, although Shimer had told Murray that Leonard and LaTulippe had absconded with $1.3 million Shimer collected from Kaivalya's investors. In February 2002, Shimer learned from a third party that Murray had met with Leonard and a doctor and that Leonard had taken money from the doctor for investment with Murray. Still, Shimer continued to solicit funds from investors to send to Tech Traders. [SMF at ¶ 52.]

Another red flag that Shimer should have paid attention to was Murray's use of the term "credits" on his statements to investors. Murray described the term to Shimer as a posting to the account of conditional profit. He also told Shimer that a "credit" was not a profit because of tax implications, which did not make sense to Shimer. Nonetheless, Shimer did not press Murray on whether the term "credits" meant profits. [SMF at ¶ 45.]

Finally, it was a red flag to both Firth and Shimer when they received information from Dennis Meyer that the information on Shasta's website, which they had been told was a unique, proprietary system developed by Murray and his son, and which they touted as such on the web site, was actually Meyer's .[SMF at ¶ 36.]

H. Shimer and Firth Knowingly or Recklessly Ignored the Need for Equity and Tech Traders to Register with the CFTC as CPOs

Shimer knew from the beginning of his relationship with Murray and Tech Traders that Equity and Tech Traders should have been registered under the Act as CPOs. He is not only a lawyer, but had taken the Series 3 examination for APs and been registered as an AP of a CPO and an IB. [SMF at ¶ 13.] In 2001, while in the formation stages of New Century

and Shasta, he told Murray that he was concerned that the way Tech Traders was accepting investors was not in compliance with the law. [SMF at ¶ 104.]. Later, in June 2001, Shimer explicitly told Murray that if he accepted funds from investors he likely needed to be registered as a CPO or as a commodity trading advisor ("CTA"). [SMF at ¶ 105.] In the fall of 2001, in the process of soliciting investors for Shasta, Shimer learned that a prospective investor named Chuck who worked for Chase Manhattan Bank questioned whether Equity, or Shasta, should be registered. Shimer researched the Act and the Part 4 Regulations that set forth the requirements for Equity to register as a CPO. He ignored and purposely misconstrued the Act and Regulations to reach a result that suited his desire not to register Equity or seek an exemption from registration. [SMF at ¶ 106.] He did not bother to obtain an opinion from experienced commodities counsel to determine if his twisted interpretation was right.

Even if Shimer's purposeful ignorance of the law in 2001 did not constitute knowledge that Equity had to register as a CPO or seek an exemption, what he learned in 2003 certainly constitutes knowledge. In October 2003, a prospective investor, Mark Munson, told Shimer and Firth that someone at the CFTC had told him that Equity or Shasta had to register. [SMF at ¶ 108.] Shimer then hired Arnold & Porter partners Geoffrey Aronow and Susan Lee, both experienced commodities counsel that had formerly held high-level positions at the CFTC. [SMF at ¶ 109.] Arnold & Porter told Shimer and Firth at the beginning of the engagement, in October 2003, that Shasta was a commodity pool and that they believed Tech Traders was a commodity pool. Arnold & Porter also told Shimer at the beginning of the engagement that Tech Traders could not trade Shasta's funds in its own name or commingle its funds with Shasta's. [SMF at ¶ 110.]

The firm also reviewed Shimer's legal analysis, first written in 2001 and updated in 2003. They told Shimer that they disagreed with his analysis that concluded that Shasta was not a commodity pool because it was not directly trading commodity futures contracts. The firm told him that he was not taking into account the Commissions regulations that state that a fund-of-funds like Shasta is itself a commodity pool. The firm also told him his analysis that Shasta or Equity did not receive compensation because it was only paid if there were profits was incorrect. [SMF at ¶ 111.]

Arnold & Porter expressed a sense of urgency in coming forward to the CFTC to attempt to cure Shasta's regulatory problems. In three separate communications in December 2003, Arnold & Porter told Shimer and Firth that they were concerned that Shasta was exposed to charges that it was running an unregistered and illegal commodity pool, aiding and abetting Tech Trader's operation of an illegal commodity pool and that it could be exposed to substantial penalties and a trading ban. [SMF at ¶¶ 115-117.] They told Shimer that they could not understand why Tech Traders was dragging its feet in obtaining counsel and dealing with the regulatory concerns. [Id.] Shimer told Lee that Murray was a secretive man who had to be treated gingerly because Shasta wanted to continue to trade through Tech Traders. [SMF at ¶ 117.] Therefore, Shimer and Firth ignored the information Arnold & Porter gave them and continued to operate Shasta without registration.

III. ARGUMENT

A. Equity, Shimer and Firth Violated §4o(1)(B) of the Act by Engaging in a Course of Business that Operated as a Fraud on Shasta's Participants.

Section 4*o*(1) of the Act, in two provisions, broadly prohibits fraud and misrepresentation by CTAs, CPOs and their APs. Section 4*o*(1)(A) of the Act makes it unlawful for a CPO or a CTA or their APs to employ any device, scheme or artifice to

defraud any participant or prospective participant by use of the mails. Section 4*o*(1)(B) of the Act makes it unlawful for a CPO or a CTA or their APs to engage in any transaction, practice or course of business that operates as a fraud or deceit upon any participant or prospective participant by use of the mails. These sections apply to all CPOs or CTAs and their APs whether registered, required to be registered, or exempted from registration. *See* Commission Regulation 4.25, 17 C.F.R. § 4.25 (2005); *CFTC ex rel Kelley v. Skorupskas*, 605 F.Supp. 923, 932 (E.D. Mich. 1985). As set out below, Equity was acting as a CPO and Firth and Shimer were Equity's APs in handling investments into Shasta.

Unlike Section 4b of the Act, the language of Section 4*o*(1) does not expressly require "knowing" or "willful" conduct as a prerequisite for establishing liability. In this regard, the CFTC has held "[a]lthough scienter must be proved to establish a violation of section 4b and section 4*o*(1)(A), it is not necessary to establish a violation of section 4*o*(1)(B)." *In re Kolter*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,262 at 42,198 (CFTC Nov. 8, 1994) (aff'g grant of summary disposition). The CFTC's view accords with a number of federal court decisions, *e.g.*, *Messer v. E.F. Hutton & Co.*, 847 F.2d 673, 678-79 (11th Cir. 1988), *CFTC v. Schafer,* 1997 WL 33547409 (S.D.Tex.) (attached hereto as Attachment 1). The language of Section 4o(1)(B) punishes "any transaction, practice, or course of business which operates as a fraud or deceit," and thereby focuses upon the effect an actor's conduct has on its investing customers rather its culpability, and so does not require a showing of scienter. *Commodity Trend Service, Inc. v. CFTC*, 233 F.3d. 981, 993 (7th Cir. 2000).

Thus, it is not necessary to show that Shimer or Firth intended to defraud Shasta participants to hold them liable under §4*o*(1)(B), but only that they acted intentionally. *See*

First National Monetary Corp. v. Weinberger, 819 F.2d 1334, 1342 (6th Cir. 1987), *Schafer* at 11. In this case, the uncontroverted evidence shows that Shimer drafted a PPM that stated that the traders' performance would be verified and touted false performance numbers, provided false performance numbers on Shasta's website and false information that represented that Tech Trader's system was unique. [SMF at ¶¶ 8, 9, 27, 35,3 6.] Shimer also created Shasta's account statements that were supposed to be issued by Tech Traders with false information about performance. [SMF at ¶ 82.] Firth, in turn, issued false account statements to Shasta investors. [SMF at ¶ 10.]

One of the purposes of §4*o* is to "implement the fiduciary capacity that characterizes the adviser's relationship to his clients." *CFTC v. Savage,* 611 F.2d 270, 285 (9th Cir. 1980). Shimer and Firth had a fiduciary duty to the Shasta participants who invested in the Shasta pool to assure them that the phenomenal profits that they were touting were legitimate. Because of this duty, courts have generally found that providing false or misleading account statements or misrepresenting other materials facts constitutes fraud under §4*o* of the Act. *CFTC v. Schroeder,* [1984-1986 Transfer Binder] Comm.Fut.L.Rep. (CCH) ¶22,394 at 29,805 (D.Kan. Sept. 28, 1984) (unregistered CPO violated §4*o*(1) by providing misleading monthly statements to pool participants including nonexistent profits); *Skorupskas,* 605 F.Supp. at 932-33 (defendant violated §4*o* by issuing false monthly statements to customers).

1. Firth Employed Devices, Schemes or Artifices to Defraud and Engaged in Transactions, Practices or Courses of Business that Operated as a Fraud or Deceit

Firth and Shimer intentionally distributed false information about Tech Traders' trading results without fully investigating whether those results were legitimate despite many red flags about Tech Traders' operation. As the president and sole shareholder of Equity, Firth reviewed and approved the Shasta PPM; yet he did virtually nothing to determine

whether Shasta was a sound investment, besides rely on Shimer. Given Shimer's past experience in losing substantial investor funds, it was not reasonable for Firth to rely solely on Shimer to do due diligence on the Shasta investment. *Schafer* at 10, citing *Dill v. Sutton Ross Assocs., Inc.* [1984-1986 Transfer Binder] Comm. Fut. L. rep. (CCH) ¶ 22,696 at 30,968 (August 22, 1985) ("the duty of a commodity professional subject to 4o is not satisfied by the uncritical repetition of information supplied by a superior"). Thus, Firth's conduct in this case operated as a fraud on Shasta investors and should be held in violation of §4o of the Act.

Every aspect of Firth's involvement, when inspected, calls into question Firth's conduct. For example, through the Shasta PPM, Firth made representations about the due diligence he had allegedly performed to assure that Shasta's investment in Tech Traders was a sound one. The PPM stated that the Manager, Equity, had received from Tech Traders "intimate disclosure of the Trading Company's [Shasta] proprietary System, adequate information about the Trading Company's real time trading to date, as well as the opportunity for direct "on site" review of its trading operations including real time trade execution to satisfy the Company's Manager that an investment of a substantial portion of the Company's funds with the Trading Company presents an extraordinary opportunity to significantly increase the overall return on investment to the Company while providing intelligent management of investment risk." [SMF at ¶ 56.]

Firth performed no due diligence to show he was "intelligently managing the risk" of this investment of Shasta participants' funds other than visiting Tech Traders' office and watching trading on computer screens. He never saw any documentation of Tech Traders' trading results. He had no experience with commodity pools, did not know if he had ever

reviewed a commodity futures account trading statement and admitted that he had no experience with commodities trading, commodity pool accounting or pool statement preparation. [SMF at ¶ 57.] Firth mainly relied on Shimer's statements to him that Shimer had placed personal money with Tech Traders and received good results to launch what turned out to be a multi-million dollar commodity pool. [Id.]

Firth also relied entirely on Shimer to implement and monitor the independent CPA verification process – a process that Firth knew was key to assuring Shasta investors that the touted rates of return were authentic. While he acknowledged that the CPA verification process was put in place to provide comfort to investors that the trading results were authentic, and although he told investors the results were verified by a CPA, Firth did nothing to assure the process was adequate and the results it produced accurate. [SMF at ¶¶ 72-73, 127.]

Firth obviously knew that Abernethy was to perform important checks for Shasta. However, Firth did nothing to investigate Abernethy's background and did not know what, if anything, Shimer or Teague had done to investigate Abernethy's background. [SMF at ¶ 72.] Worse, Firth knew that Abernethy was not an independent accountant – as represented in the PPM – and that Abernethy solicited investors for Shasta. [SMF at ¶ 75.] Even though Firth purportedly was uncomfortable with Abernethy, he never brought his concern to Murray's attention. [SMF at ¶ 72.]

Critically, although Firth knew that the PPM made representations about the procedures that would be followed to verify the trading company results, Firth did not understand why those procedures were structured the way they were [SMF at ¶ 73], or why the AUP letter Abernethy submitted did not recite the same procedures that were in the PPM.

[Id.] Firth did not even fully understand the AUP letter Abernethy produced each month. [SMF at ¶ 73.] He assertedly thought Abernethy was looking at bank statements, but only because Shimer told him, as the AUP letter did not include that procedure; Firth did nothing independently to assure Abernethy was looking at such statements. [Id.]

Firth also knew that Shimer was producing the Shasta statements that were supposed to be coming from Tech Traders. [SMF at ¶ 82.] Nonetheless, Firth used these statements, and the verified return number produced by Abernethy, to issue account statements to investors. He also knew that Shimer owed Kaivalya investors a lot of money and about the secret profit split to Shadetree that was not disclosed in the Shasta PPM. [SMF at ¶ 31.] Firth thus intentionally prepared and distributed to investors false account statements and told investors that Tech Traders' trading results were verified when he had done no independent investigation of those results.

2. Shimer Also Employed Devices, Schemes or Artifices to Defraud and Engaged in Transactions, Practices or Courses of Business that Operated as a Fraud or Deceit

The undisputed evidence shows that Shimer intentionally distributed false performance numbers to Shasta investors without making sufficient investigation of Tech Traders' principal, Murray. Shimer also was instrumental in putting in place a faulty verification procedure that did not assure that Tech Traders' performance numbers were properly verified, and willfully ignored the obvious defects in the procedure. Shimer was aware of many red flags about Tech Traders, Murray and Abernethy that should have caused him to conduct further investigation.

From the beginning of his relationship with Murray, Shimer was aware of discrepancies in Murray's description of his past trading experience that should have put Shimer on notice that Murray might not be running a legitimate operation. He had met

Murray in 1999 while observing the trading of a system that Murray had allegedly licensed to Pinder. Shimer gave over $1.3 million of investor money to LaTulippe and Leonard to trade this system. Yet, a year later, Murray told Shimer he had been back-testing the system for a year and was just starting to trade it. Shimer never questioned why Pinder was licensing his system if Murray had not yet achieved real trading results. Murray also told Shimer, alternatively, that he had been trading Pinder's money but returned it because his lawyers said Pinder was misusing it and that he returned it when Murray suffered a trading loss. Shimer did not question these inconsistent stories. [SMF at ¶¶ 22, 23.]

Shimer also knew that Murray continued to associate with known con artists. Despite the fact that Leonard had been involved in absconding over $1 million of investor money entrusted to Shimer's care and Shimer had told Murray that Leonard was still using Murray's name to solicit funds, Shimer learned that Murray had met with Leonard and a potential investor in 2002. [SMF at ¶¶ 32, 52.]

Murray's "idiosyncrasies" were also huge warning signs that Shimer ignored. Murray's refusal to reveal how much money Tech Traders had in trade should have put Shimer on notice that Murray's operation might not be legitimate. In light of the fact that Murray would never let Abernethy "verify" that Tech Traders had enough money on deposit to cover more than Shasta's deposits was a large and waving red flag that Tech Traders was losing money and was a Ponzi scheme. [SMF at ¶ 94.] In light of the fact that Murray would not let Abernethy verify all investors' funds, and the fact that the PPM did not reveal that the trader had other investors besides Shasta, the minimum account verification Equity, through Shimer and Firth, provided to investors was very misleading.

Shimer received warnings from other professionals as well that should have put him on notice about Tech Traders. Teague warned him that an account verification that did not encompass all investor deposits to the fund was meaningless. [SMF at ¶¶ 90, 93.] When Arnold & Porter looked at the Shasta website and saw the consistent extraordinary returns they asked Shimer how he knew Tech Traders was not a Ponzi scheme. [SMF at ¶¶ 94, 125.] Shimer's response was to push Murray again to verify a balance that was more than Shasta's contribution. But Murray would not allow Abernethy to verify that Tech Traders had enough on deposit to cover even the accounts under Shimer's control – Shasta, New Century and Shadetree, the secret profit-splitting account. [SMF at ¶ 94.]

Murray's reluctance to use the term "profits" on his account statements and preference for the term "credits" was also a warning sign that Shimer ignored. [SMF at ¶ 45.]

Shimer also set up a faulty mechanism for verifying returns that operated as a fraud on investors. He hired Teague because she was a good friend – and probably subject to influence – even though she had no experience with commodity pools and told him she did not. [SMF at ¶¶ 60,61.] He then did nothing to assure Teague assured herself of Abernethy's ability to carry out a verification engagement, despite representing she had done due diligence on the "local CPA" in the PPM. [SMF at ¶ 74.] Shimer dictated the way in which profits would be defined for purposes of the AUP procedure, although he never discussed his method with Abernethy, and ignored information Teague gave him about the methods used to determine a rate of return for commodity pools with properly registered CPOs. [SMF at ¶ 76.]

Shimer also did nothing to assure that Abernethy was properly verifying results, despite having indications that Abernethy was not the proper person to perform the engagement. He knew from the first time he met Abernethy that he was having financial difficulties. [SMF at ¶ 75.] Murray asked Shimer and Firth to let Abernethy solicit investors for Shasta- which showed that neither Murray nor Abernethy had a proper appreciation of the role of a supposedly independent CPA. [Id.] Abernethy was slow to produce his AUP reports and balked at adding a sentence to his report that stated Tech Traders had a minimum balance of a certain amount, which Shimer thought would be simple to do. [SMF at ¶¶ 78, 91.] Shimer did not know what Abernethy was doing to verify trading results. He assumed that Abernethy was looking at original FCM statements and stated so in the Shasta PPM. [SMF at ¶ 81.] But when Shimer drafted language in Teague's letter to Equity passing along Abernethy's "verified" performance number, Abernethy crossed out language that stated that he was looking at original brokerage statements and had full access to in-house trading records. This revision to Teague's letter should have cause Shimer to inquire about what Abernethy was reviewing to verify returns. But Shimer just accepted his changes "word-for-word." [Id.]

Shimer also had information that Teague did not know what Abernethy was doing to verify Tech Traders' results. When Teague was investigating the different methods used by registered CPOs to calculate returns, she asked Shimer what method Tech Traders and Abernethy used. [SMF at ¶ 76.] As late as December 2003, she was asking Shimer what Abernethy was verifying. [SMF at ¶ 93.] While he often interacted with Abernethy, Teague seldom did and was discouraged by Abernethy from doing so. [SMF at ¶ 74.] Shimer had to have known he was the main point of contact Equity had with Abernethy and his verification

process. In short, it was not reasonable for Shimer to rely on Teague to assure the verification process was proper. The facts and evidence support an inference of deliberate ignorance, such as would justify an "ostrich" instruction in a criminal action. *US v. Craig*, 178 F.3d 891, 896 (7th Cir. 1999).

Even if it could be argued that Shimer did not know Tech Traders was a Ponzi scheme, he had many red flags to indicate it was not a legitimate operation. Shimer's conduct thus operated as a fraud on the Shasta investors in violation of §4*o*. *See Schafer* at 10. ("whether [AP of CPO] subjectively believed in the accuracy of [the trader's] data, he intentionally engaged in the practice and course of business of distributing account statements that were false without making sufficient investigation of the discrepancies and other trading irregularities to which he had been alerted. Consequently, the Court concludes that [the AP's] conduct operated as a fraud on the Genesis investors in violation of section 4*o*(1)(B) of the Act").

B. Equity Failed to Register as a CPO, in Violation of Section 4m(1), and Shimer Aided and Abetted Equity's Violation.

Section 4m(1) of the Act requires a CPO to be registered with the Commission and prohibits a CPO, unless so registered, from making use of the mails or any means or instrumentality of interstate commerce in connection with his business as a CPO. One acts as a CPO by, among other things, soliciting and accepting funds from multiple investors, pooling those funds together to place trades in the commodity futures markets and managing the pool. *See, e.g., In re Slusser et al.*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,701 at 48,313 (CFTC July 19, 1999), *aff'd in relevant part, sub nom. Slusser v. CFTC*, 210 F.3d 783 (7th Cir. 2000) (Respondent acted as a CPO when it accepted investment funds from individual investors who deposited funds in Respondent's bank

account for the purpose of trading in a commodity pool); *SEC v. Princeton Economic Int'l*, 73 F.Supp.2d 420, 424 (S.D.N.Y. 1999) (defendant acted as a CPO by commingling proceeds derived from sale of notes to customers in a commodity pool).

This Court has already found that Shasta was a commodity pool. *See* Opinion dated 10/4/05 [Document 266.] Equity acted as a CPO because it solicited funds from multiple investors, pooled those funds together in Shimer's attorney escrow account and forwarded them to the Tech Trader's master pool to place trades in the commodity futures markets. [SMF at ¶¶ 7, 8, 27.] Equity never claimed exemption from registration. [SMF at ¶ 3.] It used the mails and other instruments of interstate commerce in connection with its business as a CPO. [SMF at ¶ 41 .] *CFTC v. AVCO Financial Corp.*, 28 F.Supp.2d 104, 120 (S.D.N.Y. 1998)(CTA used mails and other instrumentalities of interstate commerce, such as telephones, faxes and overnight delivery services, in connection with its business as a CTA), *aff'd in relevant part sub nom. CFTC v. Vartuli*, 228 F.3d 94 (2d Cir. 2000); *CFTC v. Wall Street Underground, Inc.*, 281 F.Supp.2d 1260, 1270 (D. Kan. 2003)(CTAs used mails and other instrumentalities of interstate commerce by making extensive use of telephones, facsimile transmissions and emails in the course of marketing their trading systems.) Therefore, it violated Section 4m(1).

Shimer aided and abetted Equity's failure to register as a CPO, and is therefore liable for its registration violations of §4m(1). Liability as an aider and abetter under the Act requires proof that: (1) the Act was violated, (2) the defendant had knowledge of the wrongdoing underlying the violation, and (3) the defendant intentionally assisted the primary wrongdoer. *In re Shahrokh Nikkhah,* [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,129 at 49,887-49,888 and n.28 (CFTC May 12, 2000). The standard is also

expressed as requiring proof that Shimer "knowingly associate[d] himself with an unlawful venture, participate[d] in it as something that he wish[ed] to succeed and [sought] by his actions to make it succeed." *In re Richardson Securities, Inc.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,145 at 21,646 (CFTC Jan. 27, 1981); *accord*, *Bosco v. Serhant*, 836 F.2d 271, 279 (7th Cir. 1987), *cert. denied*, 486 U.S. 1956 (1988).

Shimer facilitated Equity's failure to register as a CPO by accepting pool funds in his escrow account and by drafting the PPM and undertaking to perform all regulatory filings for the pool without either seeking registration or seeking an exemption from registration. [SMF at ¶¶ 27, 3.] He had the requisite knowledge that Equity was a CPO. First, he was a lawyer and had taken the Series 3 examination and been registered as an AP of a CPO before. [SMF at ¶ 13.] He told Murray during the formation of Shasta in the spring and summer of 2001 that Tech Traders may be required to register as a CPO because it was taking in investor funds. [SMF at ¶¶ 104, 105.] Then, when a prospective investor questioned Shasta's registration status in the fall of 2001, he researched the regulations governing the registration of commodity pools. [SMF at ¶ 106.] Thus, he had the information that showed that Equity should be registered as a CPO. But he deliberately ignored it and solicited nearly $15 million from 65 investors over the course of the next two years.

Shimer's knowledge and intent also is made clear by his response, in 2003, when another prospective investor, Mark Munson, questioned Equity's registration status again. [SMF at ¶ 108.] Shimer hired Arnold & Porter. Two experienced commodities lawyers quickly told him that Shasta was a commodity pool, that Tech Traders was likely a commodity pool and that Tech Traders could not trade Shasta's funds in it own name or

commingle its funds with Shasta's. [SMF at ¶¶ 109-110.] Still, Shimer did nothing to bring Equity into regulatory compliance.

C. Firth and Shimer Failed to Register as APs in Violation of Section 4k(2)

Section 4k(2) of the Act makes it unlawful for any person to be associated with a CPO as a partner, officer, employee, consultant, or agent or any person occupying a similar status or performing similar functions, in any capacity that involves: (i) the solicitation of funds, securities, or property for a participation in a commodity pool; or (ii) the supervision of any person or persons so engaged, unless such person is registered under the Act as an AP of the CPO. The undisputed evidence clearly shows that Firth and Shimer acted as APs of a CPO, Equity, by soliciting funds without the benefit of registration with the Commission. [SMF at ¶¶ 11, 13, 127-129.] Therefore, their respective failures to register as APs of a CPO violate Section 4k(2) of the Act.

D. Tech Trader's Violated Regulation 4.30 and Shimer Aided and Abetted That Violation.

Tech Traders was the 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. [SMF at ¶ 9.] As CTA for the Shasta pool, Tech Traders violated Regulation 4.30 by accepting their funds and trading them in its accounts at FCMs under its own name. [SMF at ¶ 9.]

Shimer aided and abetted Tech Trader's violation of Regulation 4.30 pursuant to Section 13(a) of the Act by drafting an investment agreement between Shasta and Tech Traders that provided that pool funds will be held in the name of Tech Traders. [SMF at ¶ 37.] Shimer also drafted the PPM that also sets out that funds will be held in the name of the trading company. [Id.] Finally, he collected investor funds in an attorney escrow account in

his name and directed that those funds be wired to a bank account in Tech Traders' name. [SMF at ¶ 27.] Some of these funds were traded in FCM accounts in Tech Traders' name. [SMF at ¶ 9.]

E. Firth and Shimer are Liable as Controlling Persons for Equity's Violations.

Shimer and Firth are liable for Equity's violations of the Act, pursuant to Section 13(b) of the Act, 7 U.S.C. § 13c(b), which provides that a defendant who possesses directly or indirectly the power to direct or cause the direction of the management and policies of an entity may be liable as a controlling person of that entity, provided that the defendant either knowingly induces, directly or indirectly, the violative acts or fails to act in good faith. *Monieson v. CFTC*, 996 F.2d 852, 858 (7th Cir. 1993); *CFTC v. RJ Fitzgerald, Inc.*, 310 F.3d 1321, 1334 (11th Cir. 2002), cert denied 125 S.Ct. 808 (2004). A "fundamental purpose" of the statute is "to reach behind the corporate entity to it 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." *R.J. Fitzgerald*, 310 F.3d at 1334; *JCC, Inc. v. CFTC*, 63 F.3d 1557, 1567 (11th Cir. 1995). The statute is construed liberally and even indirect means of discipline or influence, short of actual direction, is sufficient to find liability as a controlling person. *Monieson*, 996 F.2d at 859. Liability does not depend on the controlling person's involvement in the daily operations of the business; it depends on his knowledge and power, even if the power of control or influence was not exercised. *R.J. Fitzgerald*, 310 F.3d at 1334. Because control may be exercised jointly, several persons may simultaneously be controlling persons of the same corporation. *JCC, Inc.*, 63 F.3d 1557 (three controlling persons in fraudulent solicitation scheme); *CFTC v. Baragosh,* 278 F.3d 319, 330 (4th Cir.) *cert. denied*, 123 S.Ct. 415 (2002).

Whether Shimer and Firth possessed the requisite control over the operations of Equity is a determination of fact, based upon the totality of the circumstances, including an appraisal of the influence upon management and policies of a corporation by the alleged controlling person. *Baragosh*, 278 F.3d at 330 (reversing grant of summary judgment); *AVCO Financial Corp.*, 28 F.Supp.2d at 117.

Firth has admitted that he is a controlling person of Equity. [SMF at ¶ 10.] Firth both knowingly induced and failed to act in good faith with respect to Equity's violations of §4*o* and 4m. As set forth above, he knowingly issued account statements that contained false profits and did not act in good faith when he failed to do any investigation of Tech Traders, Murray or the accountant verification process. [SMF at ¶¶ 10, 57, 58, 63, 70, 72, 73.] He also knowingly induced Equity's failure to register under §4m and did not act in good faith when he failed to register Equity despite Arnold & Porter's notice that Shasta was an illegal commodity pool. [SMF at ¶ 3, 115, 117.] Thus, Firth should be held liable as a controlling person of Equity under Section 13(b) of the Act.

Shimer also is a controlling person of Equity. Shimer is legal counsel for Shasta and its CPO, Equity, as well as the self-described "detail guy" for the operation. [SMF at ¶¶ 13, 27.] Shimer involved himself in the concept for Shasta, setting up its operation, and handling the day-to-day activities of Equity far beyond what one would expect of someone merely serving as attorney for the CPO and pool. In particular, Shimer actively solicited funds for Shasta, approved all subscription documents submitted to Shasta, accepted participant funds and deposited them into his attorney escrow account for further transmittal to Tech Traders and other entities, coordinated the activities of Abernethy and Teague, created Shasta's account statements that were ostensibly from Tech Traders and was Equity's primary contact

person for dealing with Murray. [SMF at ¶¶ 27, 127, 79, 82.] For the reasons described in support of the claims that he violated §§ 4*o* and 4m, Shimer both knowingly induced and failed to act in good faith with respect to Equity's violations and should be held liable as a controlling person of Equity under Section 13(b) of the Act.

F. Equity is Liable for the Acts of Firth and Shimer.

Section 2(a)(1)(B) of the Act, 7 U.S.C. § 2 (2002), provides that "the act, omission, or failure of any official, agent, or other person acting for any individual, association, partnership, corporation, or trust within the scope of his employment or office shall be deemed the act, omission, or failure of such individual, association, partnership, corporation, or trust, as well as of such official agent, or other person." *Stotler & Co. v. CFTC*, 855 F.2d 1288, 1291-92 (7th Cir. 1988) (principal is held liable for acts of his agents); *Rosenthal & Co. v. CFTC*, 802 F.2d 936, 966 (7th Cir. 1986) (principals are strictly liable for the acts of the agents even if the agents are not employees).

Firth's actions, described above, were done within the scope of his employment with Equity, and Shimer's actions were done within the scope of his acts as employee, agent and AP with Equity. Therefore, Equity is liable for Firth's and Shimer's violations of §4*o* and 4k(2).

IV. IMPOSITION OF A PERMANENT INJUNCTION

Because enforcement proceedings under Section 6c of the Act, 7 U.S.C. § 13a-1, involve the public interest rather than a private controversy, the equitable jurisdiction of the district court is very broad, and the court's equitable powers are broader and more flexible than in private controversies. *CFTC v. Hunt*, 591 F.2d 1211, 1223 (7th Cir.), *cert. denied*, 442 U.S. 921 (1979), citing *Porter v. Warner Holding Co.*, 328 U.S. 395, 398 (1946).

An action for a statutory injunction, such as this action which is grounded in Section 6c of the Act, 7 U.S.C. § 13a-1, need not meet the requirements for an injunction imposed by traditional equity jurisprudence. The CFTC must show only two things to obtain permanent injunctive relief: first, that a violation of the Act has occurred and second, that there is a reasonable likelihood of future violations. *CFTC v. Muller*, 570 F.2d 1296, 1300 (5th Cir. 1978); *accord, CFTC v. British American Commodity Options Corp.*, 560 F.2d 135, 141 (2nd Cir. 1977), *cert denied*, 438 U.S. 905 (1978); *Hunt*, 591 F.2d at 1220, 591 F.2d at 1223 (actions for statutory injunctions need not meet the requirements for an injunction imposed by traditional equity jurisprudence. Once a violation is demonstrated, the moving party need show only that there is some reasonable likelihood of future violations.) *Accord, CFTC v. Rosenberg,* 85 F.Supp.2d 424, 454 (D.N.J. 2000).

The evidence supporting this motion for summary judgment, discussed above, amply demonstrates that Shimer and Firth violated §§4*o* and 4k of the Act and are liable for Equity's violations of §4m as controlling persons. The evidence also shows that Shimer is liable for violating §4m and Regulation 4.30 as an aider and abettor. Equity, which only operated through Shimer and Firth, is liable under §2(A)(1)(B) of the Act. Shimer's and Firth's past business experiences also demonstrate that they have a long history of losing investor money in deals that turn out to be frauds. This history shows that there is a reasonable likelihood that Firth, Shimer and Equity will engage in future violations unless enjoined.

While past misconduct does not necessarily lead to the conclusion that there is a likelihood of future misconduct, it is "highly suggestive of the likelihood of future violations." *Hunt*, 591 F.2d at 1220; *British American Commodity Options Corp.*, 560 F.2d

at 141.[7] Courts look to the "nature of the past misconduct, whether the defendant's business interests place him in a position where future violations are possible, the persistence of the violating conduct and whether the defendant has maintained that his conduct was blameless to determine whether an injunction is appropriate." *Rosenberg,* 85 F.Supp.2d at 454, *citing Hunt*, 591 F.2d at 1220 (collecting cases) and *Skorupskas*, 605 F.Supp. at 942-43.

Shimer and Firth's past business dealings, in which they solicited money from others for fraudulent business deals, shows their propensity to engage in businesses that operate as a fraud. Shimer's conduct in this case is particularly egregious – he lost over $1.3 million of investors' money in the three failed business deals for which he exercised no due diligence and then to solve that problem, created Shasta to obtain the secret "profits" through Shadetree to pay back Kaivalya investors, set up faulty procedures for verifying trading results to entice new investors and ignored red flags that would indicate Tech Traders was a fraud. Firth assisted in soliciting 65 investors to invest nearly $15 million, also ignored red flags and otherwise relied entirely on Shimer, whom he knew had set up Shasta to deal with his Kaivalya problem. Although only a "reasonable likelihood of future violations" is

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[7] . In fact, Shimer and Firth's registration violations alone are sufficient to warrant an injunction. As the Second Circuit has stated:

> The intent of the congressional design is clear; persons engaged in the defined regulated activities within the commodities business are not to operate as such unless registered, the Commission is charged in the first instance with determining the applicant's qualifications and whether proper grounds exist for refusing registration, and the Commission is empowered to seek injunctive prohibitions against violations of any provisions of the Act, including registration provisions.
>
> Registration is the kingpin in this statutory machinery, giving the Commission 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.

British American, 560 F.2d at 139-140. Shimer's and Firth's registration violations are particularly outrageous here when Shimer knew the law at least as early as 2001 and both Shimer and Firth were told Equity was running an illegal commodity pool by Arnold & Porter in 2003.

required under the *Hunt* standard, the pervasive nature of Firth's and Shimer's misconduct, coupled with their past experience in enticing investors to invest in fraudulent schemes, indicates there is a substantial likelihood of future violations. Under these circumstances, a permanent injunction is warranted against Shimer and Firth and their conduit, Equity.

V. AWARDS OF RESTITUTION AND DISGORGEMENT SHOULD BE ENTERED

It is well settled that, in CFTC injunctive actions, ancillary orders of disgorgement and/or restitution may issue. *CFTC v. Co Petro Marketing Group, Inc.*, 680 F.2d 573, 583-584 & n.16 (9th Cir. 1982) (affirming district court award of disgorgement and noting that "future compliance may be more definitely assured if one is compelled to restore one's illegal gains"), *citation omitted*; *CFTC v. U.S Metals Depository*, 468 F. Supp 1149, 1163 (S.D.N.Y 1979) (ancillary relief in the form of disgorgement awarded because to permit defendants to retain even a portion of their illicit profits "would impair the full impact of the deterrent force that is essential if adequate enforcement of the Act is to be achieved; [o]ne requirement of such enforcement is a basic policy that those who have engaged in proscribed conduct surrender all profits flowing therefrom"). *CFTC v. Noble Wealth Data Information Services, Inc.* 90 F.Supp.2d 676, 693 (D.Md. 2000), *aff'd in part rev'd in part on other grounds*, *CFTC v. Baragosh,* 278 F.23d 319 94th Cir.) *cert. denied*, 123 S.Ct. 415 (2002). *See generally F.T.C. v. Gem Merchandising Corp.,* 87 F.3d 466, 469 (11 Cir. 1996)("[A]bsent a clear command to the contrary, the district court's equitable powers are extensive. Among the equitable powers of a court is the power to grant restitution and disgorgement.")

This Court has previously approved an interim distribution plan to Tech Trader's investors, including Shasta. *See Order Dated 9/26/05* [Document 257.] and *Order Dated*

10/27-05 [Document 279.] Under these Orders, Shasta investors received interim distributions of 36.5% of allowed claims from funds that were frozen and placed under receivership when this case was filed. These investors are still owed 63.5% of their claims, or a total of $8,291,269.99 *See* Affidavit of Stephen T. Bobo at ¶ 11. Equity, Shimer and Firth should be ordered to pay this shortfall to the Shasta investors.[8] *Skorupskas*, 605 F.Supp. at 943 (ordering distribution of assets gained from fraudulent solicitation of investors).

Shimer and Firth should also be ordered to disgorge the payments they received from Tech Traders as management fees and pursuant to the secret profit splitting arrangement they had with Murray. Shimer profited from this scheme in the amount of $1,453,030.00 and Firth profited by $449,400. *See* McCormack Declaration *at* ¶¶ 14, 15. These funds should be restored and returned to the receivership estate for further distribution to investors according to a final distribution plan. [9]

VI. CIVIL MONETARY PENALTIES SHOULD BE IMPOSED

Civil monetary penalties should also be assessed against Equity, Shimer and Firth pursuant to Section 6c(d)(1) of the Act, 7 U.S.C. § 13a-1(d)(1), which provides that this Court may impose a civil penalty in the amount of "not more than the higher of $100,000[10] or triple the monetary gain to the person for each such violation." "The purpose of sanctions

[8] The restitution amount may be adjusted by the Receiver's later recoveries from third parties, in which case Equity's Firth's and Shimer's restitution obligations would be accordingly reduced.

[9] If this Motion for Summary Judgement is granted, the Commission respectfully requests permission to submit a further request for prejudgment interest on the restitution and disgorgement amounts.

[10] Pursuant to 17 C.F.R. §143.8(a)(1)(ii)(2005) the statutory maximum applicable to violations under Section 6(c) of the Act was increased from $100,000 to $120,000 per violation for violations committed on or after October 23, 2000 and to $130,000 per violation for violations committed on or after October 23, 2004.

under the Act is twofold: 'to further the [Act's] remedial policies and to deter others in the industry from committing similar violations.'" *Reddy v. CFTC,* 191 F.3d 109, 123 (2d Cir. 1999). This Court should assess a civil monetary penalty that is appropriate to the gravity of the Defendants' offenses and is sufficient to act as a deterrent. *Miller v. CFTC,* 197 F.3d 1227, 1236 (9th Cir. 1999). In this case, the gain to Equity was $612,500[11], to Firth was $449,400 and to Shimer was $1,453,030. Triple those amounts are Equity: $1,837,500, Shimer: $4,359,090, Firth: $1,348,200. Civil penalties in these amounts are warranted here. Such civil penalties are particularly appropriate here where these gains were appropriated from investor funds and, in part, pursuant to a secret profit sharing arrangement with Tech Traders that was not disclosed to the investors.

VII. CONCLUSION

The pleadings, depositions, documents and admissions filed in support of this Motion for Summary Judgment apply demonstrate that Shimer and Firth have violated §§4*o,* and 4k of the Act, that Equity has violated §4m, that Shimer has aided and abetted Equity's § 4m violation, and Tech Trader's Regulation 4.30 violation, that Shimer and Firth are liable for Equity's violation of §§4m and 4*o* as controlling persons and Equity is liable as principal for Shimer's and Firth's §§4*o* and 4k violations. Therefore, this Court should grant a permanent injunction on those charges and impose a restitution award against Equity, Shimer and Firth, jointly and severally, in the amount of $8,291,269.99 , disgorgement of $1,453,030.00 against Shimer and $449,400 against Firth and civil monetary penalties of $1,837,500 against Equity, $4,359,090 against Shimer and $1,348,200 against Firth.

[11] *See* McCormack Declaration at ¶ 10.

Date: April 7, 2005

Respectfully submitted,

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ATTACHMENT 1

Not Reported in F.Supp., 1997 WL 33547409 (S.D.Tex.)

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Only the Westlaw citation is currently available.

United States District Court,
S.D. Texas, Houston Division.
COMMODITY FUTURES TRADING COMMISSION, Plaintiff,
v.
Christopher C. SCHAFER; Peter J. Urbani; Alchemy Financial Group, Inc.; and A.R.S. Financial Services Defendants.
No. Civ.A. H-96-1213.

Filed April 17, 1996.
Dec. 23, 1997.

Daniel David Hu, U.S. Attorneys Office, Houston, TX, W Derek Shakabpa, Commodity Futures Trading Commission, Legal Counsel, Washington, DC, Michael Solinsky, Commodity Futures Trading Commission, Washington, DC, for Commodity Futures Trading Commission, plaintiff.

Robert H McKnight, Jr, England and McKnight, Roswell, GA, for Christopher C Schafer, defendant.

John A Buckley, Jr, Greer Herz & Adams, Galveston, TX, for Peter J Urbani, defendant.

Robert H McKnight, Jr, (See above), for A.R.S. Financial Services, defendant.

MEMORANDUM AND ORDER

WERLEIN, J.

*1 Pending is Plaintiff Commodity Futures Trading Commission's Motion for Summary Judgment (Document No. 40). After carefully considering the motion, the response, the briefs, and the applicable law, the Court concludes that Plaintiff's Motion for Summary Judgment should be GRANTED in part and DENIED in part. [FN1]

FN1. Urbani's and Alchemy's objection to the affidavits of Robert P. Shiner, Patricia A. Schiller, and Paul H. Bjarnason, Jr., all employees of the Commodity Futures Trading Commission, on the ground that these witnesses were not timely disclosed pursuant to Fed.R.Civ.P. 26(a) is OVERRULED. The affidavits of these witnesses were attached as exhibits in support of Plaintiff's Motion for Statutory *Ex Parte* Restraining Order and its Motion for Preliminary Injunction, both of which were provided to Defendants when they were served with a summons in this action on April 18, 1996, well before the time to make the required Rule 26(a) initial disclosures. (Document Nos. 21 and 22).

I. *Background.*

Plaintiff Commodity Futures Trading Commission ("CFTC" or the "Commission") commenced this action against Defendants Christopher C. Schafer, Peter J. Urbani, Alchemy Financial Group, Inc., and A.R.S. Financial Services alleging numerous violations of the **Commodity Exchange** Act ("CEA" or the "Act"), 7 U.S.C. § 1, *et. seq.* (1980 & Supp.1997), and the accompanying Commission Regulations, 17 C.F.R. § 1.1, *et. seq.* (1996), in connection with their operation of the Genesis Limited Partnership, a commodity pool. Additionally, Schafer is charged with other violations related to certain of his individual investment activities. In this action, CFTC seeks a permanent injunction and other equitable relief, including restitution, disgorgement, and a civil penalty.

The Key Players

1. Genesis Limited Partnership ("Genesis" or the "Genesis Pool") was a limited partnership commodity pool [FN2] organized for the purpose of trading commodity futures contracts. [FN3] Genesis is not now and never has been registered

with the Commission in any capacity.

> FN2. A commodity pool is an investment organization in which funds of various investors are solicited by a person or entity for the purpose of combining those funds into a common fund and then using those common funds for the purpose of investing in commodity futures contracts. In a commodity pool, participants share in accrued profits from the commodity futures trading on a pro rata basis; that is, to the extent that they contributed funds, they get the same percentage of the profits and the losses charged to them. *Commodity Futures Trading Comm'n v. Heritage Capital Advisory Servs., Ltd.*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,627 at 26,382 (N.D.Ill. Nov. 8, 1982).

> FN3. A commodity futures contract is a contractual obligation to make or take delivery of a specified quantity and quality of a commodity at a particular time or date in the future. Such futures contracts are traded on contract markets which are designated by the Commission for that purpose. *Heritage Capital,* at ¶ 21,627 at 26,382.

2. Alchemy Financial Group, Inc. ("Alchemy") is a Texas corporation, organized and incorporated on or about May 4, 1995. The principal place of business of Alchemy is 12931 Wincrest Court, Cypress, Texas, 77429. Alchemy was the general partner of the Genesis Limited Partnership. Alchemy is not now and never has been registered with the Commission in any capacity.

3. A.R.S. Financial Services ("ARS") was the sole proprietorship of Defendant Christopher C. Schafer. The principal place of business of ARS is 10574 Wynbridge Road, Alpharetta, Georgia, 30202 or 7 Connie Street, Cartersville, Georgia. ARS was used primarily as the vehicle through which Defendant Schafer traded commodity futures contracts on behalf of the Genesis pool investors. ARS is not now and never has been registered with the commission in any capacity.

4. Christopher C. Schafer ("Schafer"), 37 Country Walk, Cartersville, Georgia. During the relevant period, Schafer resided at 7 Connie Street, Cartersville, Georgia, or 10575 Wynbridge Road, Alpharetta, Georgia, 30202. Schafer was the sole proprietor of ARS, and a director and officer of Alchemy. Schafer is not now and never has been registered with the Commission in any capacity.

5. Peter J. Urbani ("Urbani"), 12931 Wincrest Court, Cypress, Texas, 77429, was a director, officer, and principal of Alchemy. Urbani is not now and never has been registered with the Commission in any capacity.

6. William Eldridge ("Eldridge") was an officer of Alchemy and assisted Urbani in the Genesis operation. Eldridge is not charged with any violations of the CEA or the Commission Regulations in this action. Eldridge is not now and never has been registered with the Commission in any capacity.

The Genesis Investment Scheme

***2** From March 1995 through March 1996, Schafer, Urbani, and Eldridge organized and operated the Genesis Limited Partnership for the purpose of trading commodity futures contracts for a group of individual investors. The Genesis Limited Partnership was organized as follows. Alchemy was the general partner and commodity pool operator for Genesis. Alchemy, through Schafer, Urbani, and Eldridge solicited, accepted and received funds from individual investors. The funds were then deposited into a common account and given to Schafer and/or ARS. Pursuant to his self-designed trading model, Schafer invested the funds in various commodity futures contracts. As compensation, 50% of the profits from the Genesis investments went to Alchemy and were divided among Schafer, Urbani, and Eldridge 25%, 12.5%, and 12.5%, respectively. [FN4]

> FN4. Within the organizational structure, itself, Schafer, Urbani, and Eldridge

> played numerous, often overlapping roles. Urbani and Schafer were named as directors of Alchemy in the company's incorporation documents. Although no formal meetings were held to elect officers and/or directors, Urbani represented himself on different occasions either as president or vice president of Alchemy. Eldridge, too, was an officer of Alchemy and represented himself to investors as vice president of the company.

Beginning in April 1995, Schafer, Urbani, and Eldridge through Alchemy and ARS recruited fifteen individuals to enter into limited partnership agreements with Genesis and to contribute funds totaling approximately $107,000. By March 1996, however, Schafer's trading had resulted in an almost total loss of the pool's capital. CFTC now claims that during the time Schafer traded for Genesis, Schafer engaged in numerous instances of fraudulent conduct. In a nutshell, CFTC argues that Schafer misappropriated Genesis funds and then created fraudulent trading statements to hide his investment losses. [FN5] The false trading statements were sent to Urbani who then incorporated the fictitious data into monthly account statements that were sent to the Genesis investors. Until March 1996, the Genesis investors were unaware that Defendants had lost almost the entirety of their investment. In addition to the fraud claims, CFTC has also charged Defendants with failure to comply with numerous CFTC regulatory requirements.

> FN5. Apparently Schafer also was trading in a number of different accounts that were unrelated to the Genesis trading, and numbers of those accounts also lost money. As those accounts accumulated negative balances, Schafer commingled customer funds, including at times funds of Genesis, to pay off the amounts due in negative accounts. (Document No. 43, ¶¶ 28-29, 83-86).

II. *The Charges.*

Defendants Schafer, ARS, Urbani, and Alchemy are charged with the following violations of the CEA and the Commission Regulations:

(1) Defendants Schafer, ARS, and Alchemy are charged with violating Section 4b(a)(ii) of the Act, 7 U.S.C. § 6b(a)(ii) (1980 & Supp.1997) by willfully making or causing to be made false statements to customers, both written and oral, in connection with the purchase or sale of commodity futures contracts.

(2) Defendants Schafer, ARS, and Alchemy are charged with violating Sections 4o(1)(A) and (B), 7 U.S.C. §§ 6o(1)(A) and (B) (1980 & Supp.1997) by distributing or causing to be distributed false account statements to customers and/or making false oral representations at various times to customers.

Defendant Urbani is charged with violating Section 4o(1)(B) of the Act, 7 U.S.C. § **6o(1)(B)** (1980 & Supp.1997) by engaging in conduct which operated as a fraud on investors.

(3) Defendants Schafer, ARS, Urbani, and Alchemy are charged with violating Sections 4.20(b) and (c) of the Commission Regulations, 17 C.F.R. § 4.20(b) and (c) (1996) by receiving funds from the Genesis commodity pool participants in a name other than that of the commodity pool.

***3** (4) Defendants Schafer, ARS, Urbani, and Alchemy are charged with violating Section 4n(4) of the Act, 7 U.S.C. § 6n(4) (1980 & Supp.1997) and Sections 4.13(b)(1) and (2) of the Commission Regulations, 17 C.F.R. §§ 4.13(b)(1) and (2) (1996) by failing to furnish to pool participants disclosure statements containing information required by the Commission and by failing to furnish to each pool participant a copy of the monthly statement received from a futures commission merchant. Defendant Urbani is also charged with failing to turn over the books and records associated with the operation of the Genesis pool when requested by the Commission.

(5) Defendants Schafer and ARS are charged with violating Section 4.30 of the Commission Regulations, 17 C.F.R. § 4.30 (1996) by soliciting, accepting or receiving client funds in the name of ARS to purchase commodity futures contracts for the Genesis pool participants, while acting as an unregistered commodity trading

advisor.

(6) Defendant Schafer is charged with violating Sections 4d(1) and (2) of the Act, 7 U.S.C. §§ 6d(1) and (2) (1980 & Supp.1997) by acting as an unregistered futures commission merchant and commingling customer funds.

III. *The Summary Judgment Standard.*

Rule 56(c) provides that "[summary judgment] shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c). A party seeking summary judgment bears the initial burden of informing the district court of the basis for the motion, and identifying those portions of the pleading, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, which the moving party believes demonstrate the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett,* 106 S.Ct. 2548, 2554 (1986).

Once the movant carries this burden, the burden shifts to the nonmovant to show that summary judgment should not be granted. *Id.* at 2553-54. A party opposing a properly-supported motion for summary judgment may not rest upon mere allegations or denials of his pleading, but must set forth specific facts showing the existence of a genuine issue for trial. *Anderson v. Liberty Lobby, Inc.,* 106 S.Ct. 2505, 2514-15 (1986). Unsubstantiated assertions that a fact issue exists will not suffice. *See Krim v. BancTexas Group, Inc.,* 989 F.2d 1435, 1442 (5th Cir.1993); *Thomas v. Price,* 975 F.2d 231, 235 (5th Cir.1992). The nonmovant "must adduce admissible evidence which creates a fact issue concerning the existence of every essential component of that party's case." *Krim,* 989 F.2d at 1442.

In considering a motion for summary judgment, the district court must view the evidence through the prism of the substantive evidentiary burden. *Anderson,* 106 S.Ct. at 2513-14. All justifiable inferences to be drawn from the underlying facts must be viewed in the light most favorable to the party opposing the motion. *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.,* 106 S.Ct. 1348, 1356 (1986). "If the record, viewed in this light, could not lead a rational trier of fact to find" for the nonmovant, summary judgment is proper. *Kelley v. Price Macemon, Inc.,* 992 F .2d 1408, 1413 (5th Cir.1993) (citing *Matsushita,* 106 S.Ct. At 1351), *cert. denied,* 114 S.Ct. 688 (1994). On the other hand, if "the factfinder could reasonably find in [the nonmovant's] favor, then summary judgment is improper." *Id.* (citing *Anderson,* 106 S.Ct. at 2511).

***4** Finally, even if the standards of Rule 56 are met, a court has discretion to deny a motion for summary judgment if it believes that "the better course would be to proceed to a full trial." *Anderson,* 106 S.Ct. at 2513. *Accord, Veillon v. Exploration Services, Inc.,* 876 F.2d 1197, 1200 (5th Cir.1989); 10A C. Wright, A. Miller & M. Kane, *Federal Practice and Procedure* § 2728 (1983).

IV. *Analysis of CFTC's Claims.*

As an initial matter, despite the serious nature of the charges against them, Defendants Schafer and ARS have not responded to CFTC's motion for summary judgment. The effect of a failure to oppose a motion for summary judgment, however, has no effect on the Court's analysis. "A motion for summary judgment cannot be granted simply because there is no opposition, even if the failure to oppose violated a local rule." *Hibernia Nat'l Bank v. Administracion Cent. Sociedad Anonima,* 776 F.2d 1277, 1279 (5th Cir.1985) (citing *John v. State of La. (Bd. Of Trustees for State Colleges & Univ.),* 757 F.2d 698, 709 (5th Cir.1985)). Rather, the movant has the burden of establishing the absence of a genuine issue of material fact and, unless he has done so, the court may not grant the motion, regardless of whether a response was filed. *Id.* A court "can only enter a summary judgment if *everything* in the record ... demonstrates that no genuine issue of material fact exists." *Keiser v. Coliseum Props., Inc.,* 614 F.2d 406, 410 (5th Cir.1980) (emphasis in original). Based upon these authorities, the Court considers CFTC's Motion for Summary Judgment in light of the entire case file,

even though Defendants Schafer and ARS failed to respond.

Count I

Violations of Section 4b(a)(ii) of the Act, 7 U.S.C. § 6b(a)(ii) (1980 & Supp.1997): Fraudulent Statements in Connection With Commodity Futures Contracts.

This section of the CEA makes it unlawful to willfully make or cause to be made false statements to customers in connection with the purchase or sale of a commodity futures contract. [FN6] Section 4b(a)(ii) is one of the antifraud subprovisions of the Act and is meant to impose upon all persons holding membership or trading privileges in a given contract market a duty of full and truthful disclosure to their commodity customers of any and all pertinent investment information. *See, e.g., Kearney v. Prudential-Bache Sec., Inc.,* 701 F.Supp. 416, 423 (S.D.N.Y.1988) (discussing legislative history).

> FN6. Section 4b(a)(ii), 7 U.S.C. § 6b(a)(ii) (1980 & Supp.1997) provides:
> It shall be unlawful (1) for any member of a contract market, or any correspondent, agent, or employee of any member, in or in connection with any order to make, or the making of, any contract of sale of any commodity in interstate commerce, made or to be made, on or subject to the rules of any contract market, for or on behalf of any other person or (2) for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery, made or to be made, for or on behalf of any other person if such contract for future delivery is or may be used for (A) hedging any transaction in interstate commerce in such commodity or the products or by-products thereof, or (B) determining the price basis of any transaction in interstate commerce in such commodity, or (C) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof ... (ii) willfully to make or cause to be made to such other person by any means whatsoever in regard to any such order or contract or the disposition or execution of any such order or contract, or in regard to any act of agency performed with respect to such order or contract for such person.

Just as the federal securities laws are intended to do, the 1974 Commodities Act amendments are meant "to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the [commodities] industry.... Selling techniques that are aimed to snow the unsophisticated customer "into parting with funds, often borrowed, which they could ill-afford to invest in even far safer enterprises," have no place in a regulated industry.

***5** *Kelley v. Carr,* 442 F.Supp. 346, 358 (W.D.Mich.1977) (citations omitted), *rev'd in part on other grounds,* 691 F.2d 800 (6th Cir.1980).

The elements of a fraud claim under Section 4b are derived from the common law action for fraud. [FN7] *Puckett v Rufenacht, Bromagen & Hertz, Inc.,* 903 F.2d 1014, 1018 (5th Cir.1990). In the context of an enforcement action under the CEA, the CFTC must prove three things. [FN8] First, the CFTC must show that the complained of omission or misrepresentation was one of material fact regarding one or more commodity futures or option transactions. *Id .; see also Saxe v. E.F. Hutton, Co., Inc.,* 789 F.2d 105, 110 (2d Cir.1986) (discussing materiality requirement). Material facts are those to which the reasonable investor might attach importance in determining a course of action. *See Affiliated Ute Citizens of Utah v. United States,* 92 S.Ct. 1456, 1472 (1971); *Shushany v. Allwaste, Inc.,* 992 F.2d 517, 521 (5th Cir.1993) ("[a] fact is considered material 'if there is a substantial likelihood that a reasonable shareholder would consider it important ..." ') (citations omitted). Second, the evidence must show that the defendant's actions were done with knowledge of their nature and character, i.e., knowledge by the offending party that material facts have been falsely represented or omitted with an intent to defraud or deceive. *See Commodity Futures Trading Comm'n*

v. Savage, 611 F.2d 270, 283 (9th Cir.1979) (4b action requires proof of scienter); *Master Commodities, Inc. v. Texas Cattle Management Co.,* 586 F.2d 1352 (10th Cir.1978) (same). Most circuits hold that knowledge can be established by demonstrating that the defendant knew the statement was false at the time it was made or that the statement was made with reckless disregard to its truth or falsity. *See Wasnick v. Refco Inc.,* 911 F.2d 345, 348 (9th Cir.1990) (misrepresentation made intentionally or with careless disregard); *Hill v. Bache Halsey Stuart Shields Inc.,* 790 F.2d 817, 822 (10th Cir.1986) (section 4b requires showing of intent beyond mere negligence); see *also Puckett,* 903 F.2d at 1018 (citing cases). Negligence, mistake, or inadvertence is insufficient to meet section 4b's scienter requirement. *Wasnick,* 911 F.2d at 348. Third, it must be proved that the misrepresentation was made with the intent to induce reliance. *See Puckett,* 903 F.2d at 1018 (relying on elements of common law fraud).

FN7. In Texas, a cause of action for common law fraud requires the plaintiff to show: "a material misrepresentation which was false, and which was either known to be false when made or was asserted without knowledge of its truth, which was intended to be acted upon, which was relied upon, and which caused injury." *Sears Roebuck & Co. v. Meadows,* 877 S.W.2d 281, 282 (Tex.1994).

FN8. In actions where the plaintiff is also seeking actual damages, there is a fourth element--reliance. That is, the plaintiff must show that such misrepresentations were the cause of his damages.
However, in enforcement actions brought by the CFTC solely to enforce the provisions of the CEA, it is not necessary to show either reliance on defendant's fraudulent misrepresentation or damages. *See JCC, Inc. v. Commodity Futures Trading Comm'n,* 63 F.3d 1557, 1565 n. 23 (11th Cir.1995) (distinguishing enforcement from reparation cases) (emphasis added); In re *Ferragamo,* [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,982 at 37,598 n. 16 (CFTC Jan. 14, 1991) (same); *see also Chevron, USA, Inc. v. Natural Resource Defense Council, Inc.,* 104 S.Ct. 2778, 2781-82 (1984) (deference to administrative agency decisions where agency has made a clear policy determination on particular issue).

Defendant Schafer

In the instant action, with regard to the first element, the summary judgment evidence establishes that in connection with his commodity trading activities, Schafer made material misrepresentations of facts when he created and distributed fictitious month-end statements. It is equally apparent from the uncontroverted summary judgment evidence that such misrepresentations were made with knowledge of their falsity and with the intent to conceal Schafer's actual trading losses. Indeed, Schafer expressly admits that the trading statements he gave to Urbani reflected trades that never took place, more trades than were actually executed, and nonexistent profits. (Document No. 43, CFTC Statement of Material Facts (hereinafter "SOMF"), ¶¶ 45-46, 50-52). As to the final element, the uncontroverted summary judgment evidence establishes that Schafer made the misrepresentations with the intent to induce both Urbani's and the Genesis participants' reliance on their accuracy. [FN9] (SOMF, ¶¶ 45-48, 50, 56-58). This conduct constitutes fraud in violation of section 4b(a)(ii) of the Act. *See Savage,* 611 F.2d at 283 (making false account statement); In re *Gutsin,* CFTC No. 95-4, 1995 WL 48452, at *5 (CFTC Feb. 7, 1995) (reported in Westlaw database FSEC-CFTC) (misrepresenting to investors that accounts were profitable when almost all funds had been lost constituted fraud). CFTC's motion for summary judgment is GRANTED on this claim.

FN9. For example, as late as March 1996, Schafer sent Urbani false information showing that the Genesis pool was making profits. The report misrepresented the pool's assets as totaling over $161,000, including net capital contributions, and

profits in excess of $90,000, when in fact Schafer had lost nearly all of the Genesis investors' funds in the fall of 1995. (SOMF, ¶ 64).

Defendant ARS

***6** The uncontroverted summary judgment evidence establishes that ARS was an unincorporated sole proprietorship owned and operated by Schafer to carry out his trading activities. [FN10] (SOMF, ¶ 5). ARS was also the name Schafer consistently used in his dealings with the Genesis pool. (SOMF, ¶¶ 3-5, 72-73). Schafer, as stated above, was a resident citizen of the State of Georgia at all times relevant to this lawsuit, as was his sole proprietorship, ARS. (SOMF, ¶¶ 3-5). Accordingly, the relationship between Schafer and ARS is governed by Georgia law. *Cf. Gearhart Indus., Inc. v. Smith Int'l, Inc.,* 741 F.2d 707, 719 (fiduciary duties of corporate officer controlled by state common law); *Clark v. Lomas & Nettleton Fin. Corp.,* 625 F.2d 49, 52 n. 3 (5th Cir.1980) (stating that matters of internal corporate power are governed by law of state of incorporation), *cert. denied,* 101 S.Ct. 1738 (1981).

FN10. Schafer operated two checking accounts for the purpose of depositing and withdrawing customer funds related to his trading activities, one in the name "Chris Schafer d/b/a A.R.S. Financial Services" and the other in the name "A.R.S. Financial Services." (SOMF, ¶ 25-26). Funds from the Genesis investors were deposited into the d/b/a account. (SOMF, ¶ 73).

Under Georgia law, there is no legal distinction between an individual and his sole proprietorship. *See Southern Guar. Ins. Co. v. Premier Ins. Co.,* 465 S.E.2d 521, 523 (Ga.Ct.App.1995) (distinguishing sole proprietorship from corporation on basis that former was not distinct entity); *Bernard v. Nationwide Mutual Fire Ins. Co.,* 426 S.E.2d 29, 31 (Ga.Ct.App.1992) (same); *Dowis v. Watson,* 289 S.E.2d 558, 558 (Ga.Ct.App.1982) ("An unincorporated sole proprietorship is not a separate legal entity from the proprietor ..."). Consequently, because Schafer's fraudulent conduct previously adjudged violative of section 4b(a)(ii) of the Act was perpetuated through ARS, ARS is also deemed to have violated section 4b(a)(ii). [FN11] CFTC's motion for summary judgment is GRANTED on this claim.

FN11. For example, some of the Genesis investors made personal checks out to ARS to secure their interest in the pool. (SOMF, ¶ 72). These funds were then deposited in the "Chris Schafer, d/b/a/A .R.S. Financial Services" account. (SOMF, ¶ 73).

Defendant Alchemy

Section 2(a)(1) of the Act, 7 U.S.C. § 4 (1980 & Supp.1997), provides:

> For the purpose of this chapter the act, omission, or failure of an official, agent, or other person acting for any individual, association, partnership, corporation, or trust within the scope of his employment or office shall be deemed the act, omission, or failure of such individual, association, partnership, corporation, or trust, as well as of such official, agent or other person.

See also 17 C.F.R. § 1.2 (1996) (same language).

Since its enactment, the courts and the CFTC have broadly read this provision to reach all forms of principal-agent relationships. *See,* e.g., *Bogard v. Abraham-Rietz Co.,* [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,273 at 29,393 n. 13 (CFTC July 5, 1984); In re *Big Red Commodity Corp.,* [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,623 at 30,666 (CFTC June 7, 1985); *Paul F. Newton & Co. v. Texas Commerce Bank,* 630 F.2d 1111, 1117-18 (5th Cir.1980) (securities fraud case). As interpreted, Section 2(a)(1) embodies a form of the common law principle of respondeat superior. *Rosenthal & Co. v. Commodity Futures Trading Comm'n,* 802 F.2d 963, 966 (7th Cir.1986); *Dohmen-Ramirez v. Commodity Futures Trading Comm'n,* 837 F.2d 847, 858 (9th Cir.1988). The common law principle of respondeat superior makes a principal strictly liable for the torts of its agents committed in furtherance of its business without regard to the

principal's own fault. *Rosenthal,* 802 F.2d at 966; *Commodity Futures Trading Comm'n v. Premex, Inc.,* 655 F.2d 779, 784 n. 10 (7th Cir.1981). This remains true even though the agent's specific conduct was carried out without the principal's knowledge. *Id.*

*7 The only qualification to the common law rule under the CEA is that the agent's misconduct occur within the course and scope of his agency and within the agent's actual or apparent authority. As described by the Seventh Circuit:

> Principals are strictly liable for their agents' acts--even if the agents are not employees--if the principals authorize or ratify the acts or even just create an appearance that the acts are authorized. This is so even though in a case of ratification or apparent authority the principal does not himself direct the act and may indeed *know nothing about it when it occurs.*

Rosenthal, 802 F.2d at 966 (emphasis added); *see also Cange v. Stotler & Co., Inc.,* 826 F.2d 581, 589 (7th Cir.1987) (knowledge not required to impose respondeat superior liability); *compare Tatum v. Smith,* 887 F.Supp. 918, 922-23 (N.D.Miss.1995) (principal not liable where clients unaware of defendant's relationship with brokerage firm), *aff'd sub nom., Tatum v. Legg Mason Wood Walker, Inc.,* 83 F.3d 121 (5th Cir.1996).

Alchemy argues in part that it cannot be held liable under the Act because Schafer's fraudulent activity was perpetuated without its knowledge. [FN12] This argument, however, is without merit as the caselaw clearly establishes that lack of knowledge does not preclude holding the principal liable for the acts of its agent. At this juncture, the only question is whether Schafer's fraud arose within the scope of his agency. *See Mast v. Best Commodities Servs., Inc.,* [1986-1987 Transfer Binder] Comm. Fut. L. Rep. ¶ 23,380 at 33,038-33,039 (CFTC Dec. 2, 1986) (liability of principal not defeated by claims that agent was not authorized to act fraudulently). The uncontroverted summary judgment evidence establishes that as an agent, director, and officer of Alchemy, Schafer was responsible for investing the Genesis funds and reporting on trades made in the Genesis accounts. In performing these authorized acts, Schafer defrauded the Genesis investors--misappropriating their funds and falsely reporting trading activity. Contrary to Alchemy's contention, it cannot now avoid liability by claiming that Schafer was not authorized to act fraudulently. *See Mast,* ¶ 23,380 at 33,038; *Premex,* 655 F.2d at 784. [FN13] Alchemy is liable for Schafer's conduct in violation of section 4b(a)(ii) of the Act, 7 U.S.C. § 6b(a)(ii) (1980 & Supp.1997). CFTC's motion for summary judgment is GRANTED on this claim.

> FN12. Alchemy also argues that Schafer could not have been acting in the scope of his employment since his actions did not benefit Alchemy and were in fact adverse to its own financial interests. It is not necessary, however, to prove a benefit to the principal in order to show an agent was acting within the scope of his agency. *See Rosenthal,* 802 F.2d at 969; *Mast v. Best Commodities Servs., Inc.,* [1987-1987 Transfer Binder] Comm. Fut. L. Rep. ¶ 23,380 at 33,038 (CFTC Dec. 2, 1986).
>
> FN13. This conclusion also furthers the policy bases underlying respondeat superior liability which is to encourage employers and other principals to monitor the conduct of those acting on their behalf. *Rosenthal,* 802 F.2d at 969. Liability under the Act is strict on the belief that "employers and sometimes other principals can in the general run of cases prevent torts committed by their employees or agents in furtherance of the employment or agency." *Id.* Particularly on the facts of this case, where the uncontroverted summary judgment evidence shows that better monitoring of Schafer's trading activity could have avoided the loss of the entirety of the Genesis funds, this rationale is furthered by holding Alchemy strictly liable for the fraudulent actions of Schafer.

Count II
Violations of Sections 4o(1)(A) and (B) of the Act, 7 U.S.C. §§

6o(1)(A) and (B)(1980 & Supp.1997): Fraud in Connection With a Commodity Pool.

Sections 4o(1)(A) & (B) of the Act, 7 U.S.C. §§ 6o(1)(A) & (B) (1980 & Supp.1997) provide that:

> It shall be unlawful for a commodity trading advisor, associated person of a commodity trading advisor, a commodity pool operator, or an associated person of a commodity pool operator by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly--
>
> ***8** (A) to employ any device, scheme or artifice to defraud any client or participant or prospective client or participant; or
>
> (B) to engage in any transaction, practice, or a course of business which operates as a fraud or a deceit upon any client or participant or prospective client or participant.

Once it is established that the party at issue is a commodity trading advisor ("CTA"), a commodity pool operator ("CPO"), or an associated person, the requirements for a fraud claim under section 4o are basically the same as for a fraud claim under section 4b. The elements are derived from the common law action for fraud. *First Nat'l Monetary Corp. v. Weinberger,* 819 F.2d 1334, 1340 (6th Cir.1987) ("The complainant has to prove that [the respondent] misrepresented a material fact which was intended to induce reliance ...").

The purpose of section 4o is to "implement the fiduciary capacity that characterizes the adviser's relationship to his clients." *Savage,* 611 F.2d at 285. Accordingly, it is generally well-understood that providing false or misleading account statements or misrepresenting other material facts constitutes fraud under Section 4o of the CEA. *Commodity Futures Trading Comm'n v. Schroeder,* [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22, 394 at 29,805 (D.Kan. Sept. 28, 1984) (unregistered CPO violated § 4o(1) by providing misleading monthly statements to pool participants including nonexistent profits); *Commodity Futures Trading Comm'n v. Skorupskas,* 605 F.Supp. 923, 932-33 (E.D.Mich.1985) (defendant violated § 4o by issuing false monthly statements to customers).

Defendant Schafer

A CTA is any person who "for compensation or profit, engages in the business of advising others, either directly or indirectly ... as to the value of or the advisability of trading ... any contract of sale of a commodity for future delivery made or to be made subject to the rules of a contract market." Section 1a(5)(A) of the Act, 7 U.S.C. § 1a(5)(A) (Supp.1997). [FN14] The uncontroverted summary judgment evidence establishes that Schafer was the only trader for the Genesis pool and the only person providing trading advice. (SOMF, ¶ 3). In addition, Schafer acknowledges that pursuant to an oral agreement among himself, Urbani, and Eldridge, he was designated to receive 25% of the Genesis pool profits from Alchemy as compensation for trading on the pool's behalf. (SOMF, ¶ 37). Accordingly, the Court concludes that Schafer acted as a CTA for the Genesis pool.

> FN14. Section 4o applies to all CTAs and CPOs, registered or otherwise. Here, Schafer was exempt from registering under the Act as a commodity trading advisor because Genesis had fewer than fifteen participants and less than $200,000 in funds. *See* 17 C.F .R. § 4.13(a)(2)(i)-(ii) (1996).

CFTC's claims against Schafer for violations of Section 4o(1)(A) and (B) rest on the same grounds as those asserted under Section 4b(a)(ii)--that Schafer made false statements about the profitability of the accounts he traded on behalf of Genesis; that he reported nonexistent trading activity; and that he provided this fictitious information to Urbani who in turn disseminated it to the Genesis investors. (SOMF, ¶¶ 48-50, 53-55, 60). [FN15] There being no evidence to controvert these facts, the Court concludes that Schafer's conduct constituted a "device, scheme or artifice to defraud" in violation of section 4o(1)(A) of the Act and a "transaction, practice, or a course of business which operate[d] as a fraud or a deceit" upon the Genesis investors in violation of section 4o(1)(B) of the Act. CFTC's motion for summary judgment is GRANTED on these claims.

FN15. Although Schafer's scienter is plainly established by the uncontroverted summary judgment evidence, (SOMF ¶ 46), there is one uncertainty in the state of the law interpreting section 4o that merits mention. Under current commission law, scienter, i.e., intent to defraud, is an element necessary to establish fraud under section 4b and under section 4o(1)(A), but not under section 4o(1)(B) of the Act. *See In re Kolter,* [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26, 262, at 42, 198-42, 199 (CFTC Jan. 20 1996) (scienter required to establish a violation of section 4o(1)(A), but not under 4o(1)(B)); *Messer v. E.F. Hutton & Co.,* 847 F.2d 673, 677-79 (11th Cir.1988) (same); *but see First Nat'l Monetary Corp. v. Weinberger,* 819 F.2d 1334, 1341-42 (6th Cir.1987) (concluding there was no scienter requirement under § 4o, without distinguishing between § 4o(1)(A) and 1(B)); *Savage,* 611 at 285 (9th Cir.1979) (same). Neither the Fifth Circuit nor the United States Supreme Court has addressed whether proof of scienter is a necessary element to establish fraud under § 4o(1)(A).

Defendant ARS

***9** Pursuant to the Court's analysis of the liability of ARS for the fraudulent conduct of Schafer discussed in Count 1, the Court concludes that ARS, through the actions of Schafer, is also deemed to have violated 4o(1)(A) and 4o(1)(B) of the CEA. CFTC's motion for summary judgment is GRANTED on these claims.

Defendant Alchemy

Because the uncontroverted summary judgment evidence establishes that Schafer was acting as an agent of Alchemy and that his misappropriation of pool funds and falsification of trading reports occurred within the scope of his employment or office with the corporation, Alchemy, too, is statutorily liable for violations of sections 4o(1)(A) and 4o(1)(B) of the Act. [FN16]

FN16. For a complete discussion of Alchemy's liability for the fraudulent acts of Schafer, see the discussion of principal-agent liability under Count 1.

Defendant Urbani

Urbani is charged only with violating section 4o(1)(B) of the Act in connection with his sending out fraudulent account statements to the Genesis investors based on the fictitious trading data provided by Schafer. Section 4o(1)(B) prohibits any commodity pool operator or associated person of a commodity pool operator from "engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant." 7 U.S.C. § **6o(1)(B)** (1980 & Supp.1997).

A commodity pool operator 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 ... for the purpose of trading in any [commodity futures contract]." Section 1a(4) of the Act, 7 U.S.C. § 1a(4) (Supp.1997). The accompanying CFTC Regulations define an associated person as "any natural person who is associated ... with ... a commodity pool operator as a partner, officer, employee, consultant, or agent ... in any capacity which involves (i) the solicitation of funds, securities, or property for a participation in the commodity pool or (ii) the supervision of any person or persons so engaged." 17 C.F.R. § 1.3 (aa)(3) (1996). It is Urbani's position that Alchemy was the only CPO for the Genesis pool and that his duties at Alchemy did not rise to the level of a CPO or an associated person.

The Court disagrees. Whether or not Urbani acted as a CPO, there is no doubt that Urbani acted as an associated person of Alchemy as to whom all parties agree was an unregistered CPO for the Genesis pool. Specifically, the uncontroverted summary judgment evidence establishes that Urbani participated directly in the solicitation of investors. Urbani organized and attended at least one meeting in May 1995 for the purpose of informing the

attendees about the Genesis pool and Schafer's investment strategy. Urbani's own accounts were used at the meeting as evidence of Schafer's trading ability. (SOMF, ¶¶ 41-42). Urbani also helped arrange an earlier meeting in Houston in March 1995 for Schafer to meet three or four potential Genesis investors. (SOMF, ¶ 42). Also evidence of Urbani's role in soliciting investors is the uncontroverted fact that Urbani signed six limited partnership agreements as the Alchemy representative. (SOMF, ¶ 34, 40, 42-43). Lastly, the summary judgment evidence shows that one investor's check was actually made out to Urbani. (SOMF, 72; CFTC Exhibit No. 81). Although Urbani makes much of the fact that Eldridge was assigned the role of "bringing in" investors and in fact signed up 60% (approximately 10) of the participants, this does not controvert the fact that Urbani also actively participated in soliciting investor funds. Accordingly, the Court concludes that Urbani's solicitation activities establish him as an "associated person" of a Alchemy, the undisputed CPO.

***10** The next inquiry then is whether Urbani engaged in a transaction, practice, or course of business that operated as a fraud on the Genesis investors. Unlike a claim arising under section 4b or 4o(1)(A) of the Act, there is no requirement of scienter to prove a section 4o(1)(B) violation. [FN17] Thus, it is not necessary to show that the CPO or associated person intended to defraud the client, but only that he acted intentionally. *See Messer,* 819 F.2d at 1342 (violation of § 4o, the complainant need only show that the [CPO or associated person] "intentionally made the statements complained of", and not that the [CPO or associated person] act with intent to defraud); *Savage,* 611 F.2d at 285 (no showing of scienter required).

> FN17. The Eleventh Circuit, the only Circuit that currently requires proof of scienter to establish a violation of section 4o(1)(A), 7 U.S.C. § 6o(1)(A) (1980 & Supp.1997), has explicitly rejected the necessity of proving scienter under section 4o(1)(B), 7 U.S.C. § 6o(1)(A) (1980 & Supp.1997). *Messer v. E.F. Hutton & Co.,* 847 F .2d at 679-80. Likewise, the CFTC does not require proof of intent to defraud under this provision. *In re Kolter,* ¶ 26,262 at 42,198-42,199.

In the instant action, the uncontroverted summary judgment evidence establishes that Urbani consistently and without hesitation incorporated Schafer's month-end trading reports into account statements provided to the Genesis investors. (SOMF, ¶ 64). Although Urbani now claims that he did not know the data Schafer provided was false, it is apparent that Urbani intentionally distributed that information without fully investigating inconsistencies in Schafer's monthly reports and other known irregularities in his trading practices. For example, on at least two occasions, Urbani discovered discrepancies between the buy and sell prices reported by Schafer and the actual prices in the futures market. (SOMF, ¶ 67). Urbani states only that he later discussed these discrepancies with Schafer. Also striking is the lack of evidence to suggest that Urbani ever *seriously* questioned the absence of facial authenticity in Schafer's trading statements and/or requested supporting documentation, other than a single handwritten note from Urbani asking Schafer who had prepared the statements. [FN18] (SOMF, ¶¶ 47, 68).

> FN18. The statements that Schafer sent to Urbani were prepared by using a common spreadsheet program. There was no heading or indication that they were created from information supplied by a registered brokerage firm or other recognized trading entity. (SOMF, ¶ 47).

Urbani also encountered other occurrences that put him on notice about Schafer's misconduct. Urbani knew in October 1995 that Schafer wrote three checks from the Alchemy account to ARS totaling $38,000, all of which bounced. (SOMF, ¶ 66). Schafer later told Urbani he mistakenly wrote the checks from the wrong account. Similarly, in late 1995, Urbani discovered that Schafer had been trading under the names of his wife and children

and not in the name of ARS as he had earlier represented. (SOMF, ¶ 69). Again, Schafer deflected Urbani's inquiries by claiming that he was merely "testing" different brokerage houses and did not want them to know of his connection with Alchemy. Yet, in spite of these incidents, Urbani continued routinely to distribute Schafer's trading reports.

This uncontroverted summary judgment evidence shows that whether Urbani subjectively believed in the accuracy of Schafer's data, he intentionally engaged in the practice and course of business of distributing account statements that were false without making sufficient investigation of the discrepancies and other trading irregularities to which he had been alerted. Consequently, the Court concludes that Urbani's conduct operated as a fraud on the Genesis investors in violation of section 4o(1)(B) of the Act, 7 U.S.C. § **6o(1)(B)** (1980 & Supp.1997). [FN19] *See Saltzman v. Financial Alternatives, Inc., et. al,* [1986-1988 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28483 at 33,291 (CFTC Feb. 17, 1987) (effort to investigate facts prior to making assurances to complainants undermined claims of asserted ignorance); *Dill v. Sutton Ross Assocs, Inc.,* [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,696 at 30,968 (CFTC Aug. 22, 1985) ("The duty of a commodity professional subject to Section 4o is not satisfied by the uncritical repetition of information supplied by a superior.") (citing cases). CFTC's motion for summary judgment is GRANTED on this claim.

FN19. In his response and supporting brief, Urbani argues only that his conduct did not violate section 4o(1)(B) of the Act, 7 U.S.C. § **6o(1)(B)** (1980 & Supp.1997) because he was neither a CPO or an associated person of a CPO. (Document Nos. 50 and 51)

Count III

Violations of Section 4.20(b) and (c) of the Regulations, 17 C.F.R. §§ 4.20(b) and (c) (1996): Receipt of Pool Funds in Name Other Than Pool's and Commingling of Pool Participants' Funds.

***11** Section 4.20(b) of the Commission Regulations requires that all funds received by a CPO from a pool participant for the purchase of an interest in that commodity pool be received in the pool's name. *See In re Custer,* CFTC No. 92-27, 1992 WL 239069, at *5-*6 (CFTC Sept. 22, 1992) (violation of 17 C.F.R. 4.20(b) found where defendant received checks in name of trading company, and not pool) (reported in Westlaw database FSEC-CFTC). Similarly, section 4.20(c) prohibits a CPO from commingling pool property and assets with the property of another person. *See Commodity Futures Trading Comm'n v. Schroeder,* [1984-1986 Transfer Binder] Comm. Fut. L. Rep .(CCH) ¶ 22,394 at 29,805 (D.Kan. Sept. 28, 1994) (deposit of customer funds into personal account and defendant's d/b/a account was violation of 17 C.F.R. 4.20(c)). However, to establish a violation of either §§ 4.20(b) or (c), it must first be shown that the defendant is a commodity pool operator. There is no liability for an associated person.

Defendant Alchemy

Defendant Alchemy admits both that it was a CPO and that its conduct with regard to the receipt and handling of the checks received from the Genesis investors was violative of both §§ 4.20(b) and (c) of the Commission regulations. Accordingly, CFTC's motion for summary judgment is GRANTED on these claims.

Defendants Schafer, Urbani, and ARS

As to Defendants Schafer, Urbani, and ARS, there are genuine issues of material fact regarding whether they functioned as commodity pool operators separate and apart from their role at Alchemy. Although there is evidence that both Urbani and Schafer (and ARS through Schafer) physically solicited, accepted, and received funds from the Genesis investors, the summary judgment evidence does not establish as a matter of law that they did so as individual CPO's rather than as agents of Alchemy. In the only case cited by the CFTC for the proposition that officers of a corporate commodity pool operator may also be liable as CPOs, the officer-defendants operated the

commodity pool at issue for approximately nine months before the corporate entity was even organized. *Commodity Futures Trading Comm'n v. Heritage Capital Advisory Services, Ltd.*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,627 (N.D.Ill., Nov. 8, 1982). During those first nine months, the individual defendants both solicited money and issued account statements in their own name. *Id.* at ¶ 26,380. Further, even after the corporation was formed, a portion of the customer funds were kept in a bank account in the name of one of the individual defendants, instead of in the name of the corporation. *Id.* at ¶ 26,381.

That is not the situation here. Schafer and Urbani, both officers and directors of Alchemy, appear to have consistently solicited clients and funds through the Alchemy entity and not in their individual capacities. [FN20] Indeed, the summary judgment evidence shows that: Alchemy was identified as the general partner in the limited partnership agreements, (Doc. No. 40, Exhibit 80); the right to manage and control the Genesis pool was assigned to Alchemy, *Id .;* 50% of the pool profits went to Alchemy and through it to Schafer, Urbani, and Eldridge, (SOMF, ¶ 37); Alchemy kept its own bank account, (Doc. No. 40, Exhibit 9A); and all correspondence with the Genesis investors was carried out in the name of either Alchemy or Genesis, (Doc. No. 40, Exhibits 102 and 104).

> FN20. In the alternative, CFTC also argues that the Court should disregard the corporate fiction and hold Urbani liable as a CPO as the alter ego of Alchemy. The Court is unpersuaded by CFTC's argument in light of the present summary judgment record. Moreover, this theory of liability was brought up for the first time in CFTC's reply to Defendant Urbani's and Alchemy's response to CFTC's Motion for Summary Judgment. Without the benefit of a reply, the Court concludes the better course is to reserve these issues for a trial on the merits.

***12** Without additional authority for holding officers of a corporate CPO liable themselves as CPOs for actions taken on behalf of the corporation, the Court concludes that CFTC's motion for summary judgment should be DENIED as to Defendants Schafer, Urbani, and ARS on these claims.

Count IV

Violations of Section 4n(4) of the Act, 7 U.S.C. § 6n(4) (1980 & Supp.1997) and Sections 4.13(b)(1) and (2) of the Commission Regulations, 17 C.F.R. §§ 4.13(b)(1) and (2) (1996): Failure to Furnish Disclosure Statements to Pool Participants; Failure to File Disclosure Statement with the Commission and National Futures Association ("NFA"); Failure to Furnish Futures Commission Merchant ("FCM") Account Statements to Pool Participants; and Failure to Provide Books and Records for Inspection by Commission.

Defendants Schafer, Urbani, Alchemy and ARS are charged with violating Section 4n(4) of the Act and sections 4.13(b)(1)-(2) of the Commission Regulations which require that commodity pool operators provide specific information about pool investments to the pool participants. In addition, Urbani also is charged with violating section 4.13(b)(2)(ii)(A) of the Commission Regulations which requires commodity pool operators to open for inspection all books and records connected to pool activities upon request by any representative of the CFTC or United States Department of Justice.

Defendant Alchemy

Again, Alchemy admits both that it was a CPO and that it did not provide the required information to the Genesis investors in violation of section 4n(4) of the Act, 7 U.S.C. § 6n(4) (1980 & Supp.1997) and sections 4.13(b)(1) and (2) of the Commission Regulations, 17 C.F.R. §§ 4.13(b)(1) and (2) (1996) . Accordingly, CFTC's motion for summary judgment is GRANTED on these claims.

Defendants Schafer, Urbani, and ARS

Pursuant to the Court's discussion under Count III, the summary judgment evidence establishes only that Defendant Alchemy is a CPO as a matter of law. Accordingly, because each of the statutory and

regulatory violations charged in this count apply only to CPOs, CFTC's motion for summary judgment is DENIED as to these defendants on these claims.

Count V

Violations of Section 4.30 of the Commission Regulations, 17 C.F.R. § 4.30 (1996): Acceptance of Client Funds in CTA's Name.

Section 4.30 of the Commission Regulations, 17 C.F.R. § 4.30 (1996), prohibits CTAs from soliciting, accepting, or receiving funds, securities, or other property from an existing or prospective clients in the trading advisor's name to purchase, margin, guarantee or secure any commodity interest of the client. 17 C.F.R. § 4.30 (1996). The uncontroverted summary judgment evidence shows that on at least four occasions in April and May 1995, Schafer, while acting as a CTA, did in fact solicit, accept, and receive personal checks from at least four different Genesis investors payable to ARS to purchase and secure the commodity interest of those clients. (SOMF, ¶¶ 72-73). The Court concludes that Schafer's actions in this regard were in violation of section 4.30 of the Commission Regulations. *See In re Liu,* CTFC No. 94-6, 1993 WL 484866, at *4 (CFTC Nov. 23, 1993) (CTA received funds in own name to purchase commodity futures contracts for clients) (reported in Westlaw database FSEC-CFTC). Moreover, Schafer's actions were taken in his assumed name, or "d/b/a," of ARS and, therefore, ARS is also liable for violating section 4.30 of the Commission Regulations. CFTC's motion for summary judgment is GRANTED on these claims.

Count VI

Violations of Sections 4d(1) and (2) of the Act, 7 U.S.C. §§ 6d(1) and (2) (1980 & Supp.1997): Acting As Unregistered Futures Commission Merchant and Commingling Customer Funds.

***13** The CEA defines a Futures Commission Merchant ("FCM") as a person or entity that:

> (A) is engaged in soliciting or accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market; and
>
> (B) in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom.

Section 1a(12) of the Act, 7 U.S.C. § 1a(12) (Supp.1997).

Section 4d(1) of the Act, 7 U.S.C. § 6d(1) (1980 & Supp.1997), mandates that all persons or entities conducting business as FCMs register as such with the Commission. Section 4d(2) of the Act, 7 U.S.C. § 6d(2) (1980 & Supp.1997), further requires that a person acting as an FCM separately account for each customer's funds, without commingling those funds with the FCM's own funds or those of other customers.

The uncontroverted summary judgment evidence establishes that Schafer acted as a FCM when he accepted $26,000 from Alistair Seneviratne for the purpose of trading commodity futures contracts (Schafer Depo., 19:12-20:3); that he was not registered as an FCM (Shiner Declaration, ¶ 5); and that he subsequently deposited Seneviratne's funds into brokerage accounts that contained his own funds as well as those of other investors on whose behalf he was also trading. (SOMF, ¶¶ 20-27). Without controverting evidence, the Court concludes that Schafer's actions violated sections 4d(1) and (2) of the Act, 7 U.S.C. §§ 6d(1) and (2) (1980 & Supp.1997). *See* In re *Weinberg,* [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,744 at 40,425-426 (ALJ June 1, 1993) (respondent violated section 4d(1) by accepting funds from a customer to place orders for futures contract while not registered), *aff'd,* CFTC No. 89-24, 1994 WL 3469 (CFTC Jan. 5, 1994) (reported in Westlaw database FSEC-CFTC); In re *Zurich Trading Corp.,* [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23270 at 32,733 (ALJ Sept. 12, 1986) (respondent failed separately to account for, and segregate funds from customers and used money from customers to margin guarantee, or secure trades of person in violation of section 4d(2) of the Act), *aff'd,* CFTC No. 82-27,

1986 WL 65945 (CFTC Nov. 24, 1986) (reported in Westlaw database FSEC-CFTC). CFTC's motion for summary judgment is GRANTED on these claims.

V. *Permanent Injunctive and Ancillary Relief.*
Section 6c of the Act, 7 U.S.C. § 13a-1 (1980 & Supp.1997), authorizes this Court to enjoin violations of, or to enforce compliance with, the Act, or any rule, regulation, or order thereunder. This section has been interpreted to give the district courts broad authority to shape the form of equitable relief warranted by a violation of the Act and/or the Commission Regulations, including whether restitution and disgorgement are compelled by the facts of a particular case. *See Commodity Futures Trading Comm'n v. P.I.E., Inc.,* 853 F.2d 721, 726 (9th Cir.1988)(disgorgement); *Commodity Futures Trading Comm'n v. Petro,* 680 F.2d 573, 583-84 & n. 17 (9th Cir.1982) (restitution and disgorgement).

***14** Plaintiff's Request for Injunctive and Ancillary Relief on the claims on which the Court has granted summary judgment involves the granting of equitable relief upon which the Court believes a hearing should be held. Whether this hearing will be set separate from the trial will be considered at docket call. Further, given the rulings of the Court herein, the parties are encouraged to confer on whether they can agree at this time on a consent judgment that might be appropriate to the circumstances. In any event, the Court presently reserves ruling on the remedies bequested by Plaintiff.

ORDER
Based on the foregoing analysis, it is

ORDERED that Plaintiff CFTC's Motion for Summary Judgment (Document No. 43) is GRANTED on the issue of liability as to the following Defendants and the following claims:

A. Defendant Christopher C. Schafer.
Count I: Section 4b(a)(ii) of the Act, 7 U.S.C. § 6b(a)(ii) (1980 & Supp.1997).

Count II: Sections 4o(1)(A) and (B) of the Act, 7 U.S.C. §§ 6o(1)(A) and (B) (1980 & Supp.1997).
Count V: Section 4.30 of the Commission Regulations, 17 C.F.R. § 4.30 (1996).

Count VI: Sections 4d(1) and (2) of the Act, 7 U.S.C. §§ 6d(1) and (2) (1980 & Supp.1997).

B. Defendant A.R.S. Financial Services.
Count I: Section 4b(a)(ii) of the Act, 7 U.S.C. § 6b(a)(ii) (1980 & Supp.1997).
Count II: Sections 4o(1)(A) and (B) of the Act, 7 U.S.C. §§ 6o(1)(A) and (B) (1980 & Supp.1997).
Count V: Section 4.30 of the Commission Regulations, 17 C.F.R. § 4.30 (1996).

C. Defendant Peter J. Urbani.
Count II: Section 4o(1)(B) of the Act, 7 U.S.C. § 6o(1)(B) (1980 & Supp.1997).

D. Defendant Alchemy Financial Group, Inc.
Count I: Section 4b(a)(ii) of the Act, 7 U.S.C. § 6b(a)(ii) (1980 & Supp.1997).
Count II: Sections 4o(1)(A) and (B), 7 U.S.C. §§ 6o(1)(A) and (B) (1980 & Supp.1997).
Count III: Sections 4.20(b) and (c) of the Commission Regulations, 17 C.F.R. § 4.20(b) and (c) (1996).
Count IV: Section 4n(4) of the Act, 7 U.S.C. § 6n(4) (1980 & Supp.1997), and Sections 4.13(b)(1) and (2) of the Commission Regulations, 17 C.F.R. § 4.13(b)(1) and (2) (1996).

It is further

ORDERED that Plaintiff's Motion for Summary Judgment is DENIED as to all remaining claims against Defendants Schafer, Urbani, and ARS. This leaves for trial only Counts III and IV against Defendants Schafer, ARS, and Urbani, and further reserves for future determination the decision on remedies.

The Clerk shall notify all parties and provide them with a true copy of this Order.

Not Reported in F.Supp., 1997 WL 33547409 (S.D.Tex.)

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