IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

U.S. Commodity Futures Trading Commission, Plaintiff, vs. Lake Shore Asset Management Limited, et al. Defendants.	Civil Action No.: 07 C 3598 Honorable Judge Manning Magistrate Judge Mason

DEFENDANT'S MEMORANDUM IN OPPOSITION TO PLAINTIFF'S MOTION FOR APPOINTMENT OF RECEIVER

Defendant Lake Shore Asset Management Limited ("LSAM") respectfully submits this Memorandum in Opposition to Plaintiff's Motion for Appointment of Receiver. For the reasons stated below, the extraordinary and drastic remedy of appointing a receiver is not warranted or practicable under the circumstances of this case and would be premature at this stage in the proceedings.

ARGUMENT

The power to appoint a receiver is a "drastic, harsh and dangerous one" and "ought never to be made except in cases of necessity upon a clear showing that [an] emergency exists." *Tcherepnin v. Franz*, 277 F. Supp. 472, 474 (N.D. Ill. 1966) (*citing Connolly v. Gishwiller*, 162 F.2d 428, 435 (7th Cir. 1947)); *Kristoff v. Lenell*, No. 84-C-2784, 1985 WL 1716, at *5 (N.D. Ill. June 10, 1985) (citation omitted); 12 Wright & Miller, Federal Practice and Procedure § 2983 (2007) (appointment of a receiver should be granted "only in cases of clear necessity to protect plaintiff's interests in the

property.") A motion for the appointment of a receiver prior to a determination of the dispute on the merits should be granted "only under the extremist of circumstances." *Kolb Coal Co. v. Sauter*, 295 F. 690, 690 (7th Cir. 1924); *Tcherepnin*, 277 F. Supp. at 474 (N.D. Ill. 1966). Here, no such circumstances exist and plaintiff Commodity Futures Trading Commission's motion for appointment of a receiver should be denied.

I. LSAM DOES NOT POSSESS ANY ASSETS FOR A RECEIVER TO ADMINISTER

There is no valid basis for appointment of a receiver in this case, because there are no assets owned or controlled by LSAM, which is the only party to appear in this case. The CFTC contends that a receiver is necessary to collect, marshal and preserve assets covered by the Court's preliminary injunction. However, the record is clear that these assets are all owned by persons other than LSAM, so that a receiver for LSAM would have no authority to take possession of the assets.

As established at the preliminary injunction proceeding, the assets are currently held with four custodians (the "Custodians"), three of which are located in London and the fourth is located in Illinois. None of the accounts maintained by the Custodians is owned by LSAM. Rather, each account is owned by a separately incorporated company which does no business in the United States or with United States investors. The account documents of the Custodians show that LSAM is not the owner of any of the accounts, and has no right to withdraw funds from any of the accounts.

Furthermore there are serious impediments under English law for this Court to appoint a receiver over the assets in England. First, English courts do not recognize, and to the contrary have rejected, the concept of "common enterprise" that this Court applied

as the basis for freezing the accounts of non-parties in England. *See, e.g., Adams v. Cape Indus. plc*, [1991] 1 All ER 929, 961-71, attached hereto as Exhibit B; *In re Polly Peck Int'l plc*, [1996] 2 All ER 433, 448, attached hereto as Exhibit C. Indeed, in rejecting the argument that a foreign corporate parent and its U.S. subsidiary should be treated as a single economic unit, the Court found that the parent corporation is "entitled . . . to organize its group activities so as to avoid being present in the United States." *Adams*, 1 All ER at 965.

Next, because the account owners of the assets held with the custodians in London are not part of this proceeding and bear no connection to the United States, it is highly unlikely that an English court would even recognize the authority of an U.S. appointed receiver. *See Schemmer v. Prop. Res. Ltd.*. [1975] EWHC (Ch) 273, attached hereto as Exhibit D. In *Schemmer*, plaintiffs sued six companies, all of which were incorporated outside of the United States, for violations of the Securities Exchange Act of 1934. *Id.* at 281-282. Three of the defendants were banks that held money in London in the name of another defendant. *Id.* at 282. The District Court for the Southern District of New York appointed a receiver and authorized the receiver to institute proceedings in the United Kingdom to secure assets held with the banks. *Id.* at 285. The receiver instituted proceedings and the Court found that in order to recognize the title of the foreign receiver or to appoint an auxiliary receiver in England, the English court must be "satisfied of a sufficient connection between the defendant and the jurisdiction in which the foreign receiver was appointed to justify recognition of the foreign court's order, on English conflict principles, as having effect outside such jurisdiction." *Id.* at 287. The court found no connection because (1) the Bahama Islands corporation ("PRL") was not made

a defendant in the U.S. proceeding; (2) PRL was not incorporated in the United States; (3) there was no evidence that the Bahamas would recognize the U.S. order as affecting English assets; and (4) there was no evidence that PRL itself, as opposed to associated companies, did business in the United States or that its central management and control was located in the United States. *Id.* at 287-88.

Similarly here, an English court would be unlikely to recognize the authority of an U.S. appointed receiver because (1) the rightful account owners of the assets are not defendants in this proceeding; (2) these owners are not incorporated in the United States; (3) there is no evidence that the nations in which these owners are incorporated would recognize such an U.S. order; and (4) there is no evidence that any of these foreign entities are conducting business in the United States or are headquartered in the United States. Therefore, under English law, there would be an insufficient connection between the assets in England and a receiver for LSAM appointed by an U.S. court for the receivership to be recognized under English law.

The assets at Sentinel are also unavailable for a receiver to administer. In addition to the fact that the assets are not owned or controlled by LSAM, they are within the jurisdiction of the Bankruptcy Court, and the automatic stay in bankruptcy would preclude a receiver from obtaining them. *See* 11 U.S.C. § 362(a)

Nor may a receiver be appointed to administer the assets of Lake Shore Asset Management Group of Companies, Inc. Ltd. ("Lake Shore Group") or Philip J. Baker. As with LSAM, neither Lake Shore Group nor Baker owns any of the frozen assets, so

there is nothing for a receiver to administer. Moreover, neither has been served and therefore, neither is present in this case to be a subject of relief.[1]

II. THE APPOINTMENT OF A RECEIVER WOULD BE PREMATURE

The appointment of a receiver would be premature at this point in the litigation. First, the purpose of a preliminary injunction is to preserve the status quo until a trial on the merits can be held. *University of Texas v. Camenisch*, 451 U.S. 390, 395 (1981) ("[I]t is generally inappropriate for a federal court at the preliminary-injunction stage to give a final judgment on the merits."); *Indiana Civil Liberties Union v. O'Bannon*, 259 F.3d 766, 770 (7th Cir. 2001). Moreover, the findings of fact and conclusions of law made by a court granting a preliminary injunction are not binding at trial or at a hearing for a permanent injunction. *University of Texas*, 451 U.S. at 395; *Gould v. Lambert Excavating, Inc.*, 870 F.2d 1214, (7th Cir. 1989). As such, in situations where the appointment of a receiver is warranted (and this is not such a situation), the appointment is more appropriately granted as final relief after an adjudication on the merits. Here, the appointment of a receiver at this stage of the litigation would upset the status quo and have the effect of precluding LSAM from a full adjudication on the merits. Therefore, the CFTC's motion for appointment of a receiver should be denied.

[1] Although the CFTC contends that its has properly served Lake Shore Group by serving brokers in the United States and by service on counsel for Mr. Rosenberg, neither of these means constituted proper service on Lake Shore Group. Mr. Rosenberg was not an authorized representative of Lake Shore Group (*See* Ex. A hereto) and service on a broker is not a proper method of service. Fed. R. Civ. P. 4. The CFTC is apparently basing its claims of service upon the brokers on CFTC Reg. §15.05(b), 17 CFR §15.05(b), which makes a broker an agent for its foreign customers for purposes of receiving communications from the CFTC. However, Lake Shore Group has no accounts with the brokers and therefore is not within this section. Moreover, a summons (other than an administrative summons issued by the CFTC) is not a communication from the CFTC, but rather is process from the Court, so it is also not within this section.

Second, contested issues in this case are currently being presented to the Court of Appeals on an expedited basis. LSAM's opening brief is due September 20, 2007, with the CFTC's response due on October 4, 2007, and the reply brief due on October 11, 2007. Oral argument is scheduled for October 23, 2007. Given this expedited appeal and the expectation that these issues will be promptly resolved by the Court of Appeals, the appointment of a receiver at this stage of the proceedings would be premature. *See Star Ins. Co. v. Risk Mktg. Group, Inc.*, No. 06-C-1364, -- F. Supp. 2d --, 2007 WL 2580478, at *5 (N.D. Ill. Aug. 31, 2007) (finding appointment of a receiver pending the litigation to be premature).

Moreover, the appointment of a receiver while the appeal is pending would deprive LSAM of its right to continue to prosecute its appeal. If a receiver were appointed for LSAM, that receiver would succeed to LSAM's rights and would have no interest in pursuing the appeal. It would be unfair and prejudicial to deprive LSAM of its appeal in this manner.

III. THE APPOINTMENT OF A RECEIVER IS NOT NECESSARY TO PROTECT THE INTERESTS OF THE CFTC OR INVESTORS

In considering whether the appointment of a receiver is appropriate, courts generally consider several factors, including fraudulent conduct on the part of defendant; imminent danger of the property being lost, diminished in value, or squandered; the inadequacy of the available legal remedies; the probability that harm to plaintiff by denial of the appointment would be greater than the injury to the parties opposing appointment; and plaintiff's probable success in the action and possibility of irreparable injury to its interests in the property. 12 Wright & Miller § 2983; *CFTC v. Comvest Trading Corp.*,

481 F. Supp. 438, 441 (D. Mass. 1979). In considering these factors, it is clear that the extraordinary and harsh remedy of receivership is not warranted in this case.

The purpose of receivership is to maintain the status quo and preserve the assets in controversy pending the resolution of the litigation. *See O'Dowd v. Anderson*, No. 96-C-820, 1997 WL 563971, at *3 (N.D. Ill. July 11, 1997) (stating appointment of receiver is appropriate only in "cases of urgent necessity" where there is an "imminent danger of dissipation of the corporate assets"); *Chicago Title & Trust Co v. Mack*, 347 Ill. 480, 483 (Ill. 1932) (discussing origins of receivership in English Court of Chancery). Here, by Memorandum and Order ("Order") dated August 28, 2007, the Court entered an asset freeze that prohibits LSAM from "withdrawing, transferring, removing, dissipating, concealing or disposing of . . . any assets . . . on deposit in any financial institution." Order, at 84-85 ¶ 3. The current asset freeze is a continuation of various asset freezes that have been in effect since June 22, 2007. Moreover, even absent an asset freeze, LSAM does not own or have authority to withdraw or otherwise dispose of the assets held with the Custodians. Additionally, the assets held with Sentinel Management Group, Inc., which represent the only assets held in the United States, are in the custody of a Bankruptcy Trustee appointed by the Bankruptcy Court. For these reasons, the CFTC has not shown that the assets currently frozen are in danger of being squandered or lost as a result of any action by LSAM.

Indeed, as the cases cited by the CFTC illustrate, a receiver is not appropriate under these circumstances because the asset freeze imposed by the Court's order, together with LSAM's lack of authority over the assets, ensures that the assets are not in danger of diversion or waste by LSAM. *See, e.g., CFTC v. Co Petro Mktg Group, Inc.*,

680 F.2d 573 (9th Cir. 1982); *SEC v. First Fin. Group of Texas*, 645 F.2d 429, 438 (5th Cir. 1981) (receiver appropriate where in its absence "corporate assets will be subject to diversion and waste"); *CFTC v. Skorupskas*, 605 F. Supp. 923, 934 (E.D. Mich. 1985) (appointing receiver by agreement of the parties). Nor does the CFTC's citation to *CFTC v. Muller*, 570 F.2d 1296 (5th Cir. 1978), support the CFTC's motion for appointment of a receiver. The remedy imposed in *Muller* for an employee's misappropriation of customers' funds was an asset freeze and not the appointment of a receiver. *Muller*, 570 F.2d at 1301; *see also Comvest Trading Corp.*, 481 F. Supp. at 442 (refusing CFTC's request to appoint receiver where asset freeze adequately protected the property).

Finally, the CFTC has not established that the "benefits reasonably to be expected from receivership outweigh the resulting burdens, including costs of the receivership itself." *Comvest Trading Corp.*, 481 F. Supp. at 442. Receivers are expensive, and a receiver for LSAM would accomplish nothing more than is already accomplished by an asset freeze against LSAM. Moreover, if a receiver were granted access to frozen funds of investors to compensate the receiver, the injury to the investors by the appointment of a receiver would greatly outweigh any benefit of a receiver.

Conclusion

WHEREFORE, for the reasons stated above, defendant Lake Shore Asset Management Limited respectfully requests that the Court deny plaintiff Commodity Futures Trading Commission's motion for appointment of receiver.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I, Steven E. Sexton, an attorney, hereby certify that I have caused copies of the foregoing Defendant's Memorandum in Opposition to Plaintiff's Motion for Appointment of Receiver and exhibits attached thereto to be served upon the following individuals by ECF Notification and Electronic Means on September 19, 2007.

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