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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)** **TRIAL DATE: August 27, 2007**

CFTC'S TRIAL BRIEF

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CFTC'S TRIAL BRIEF

Plaintiff Commodity Futures Trading Commission ("the Commission" or "CFTC") respectfully submits this trial brief in support of its upcoming trial against Defendants Equity Financial Group, LLC ("Equity"), Robert W. Shimer ("Shimer") and Vincent J. Firth ("Firth").

A large portion of this case has already been decided. On December 18, 2006, the Court granted the CFTC's motion for partial summary judgment, finding that a) Equity violated § 4m(1) of the Commodity Exchange Act ("the Act"), 7 U.S.C. § 6m(1)(2002) by acting as an unregistered commodity pool operator ("CPO"); b) Shimer and Firth acted as unregistered associated persons ("APs") of Equity in violation of § 4k(2), 7 U.S.C. § 6k(2); c) Firth and Shimer violated § 4*o*(1)(B), 7 U.S.C. § 6*o*(1)(B) because they engaged in a course of business that operated as a fraud on Shasta's participants and d) Equity is liable for Firth's and Shimer's violations of §§ 4k(2) and 4*o*(1)(B) under 7 U.S.C. § 2(a)(1)(B). *CFTC v. Equity Fin. Group*, No. 04-1512, 2006 WL 3751911 (D.N.J. Dec. 18, 2006) ("CFTC SJ Decision"). On March 30, 2007, the Court found that Shimer aided and abetted Tech Traders, Inc's violation of 17 C.F.R. § 4.30 on the CFTC's motion for reconsideration of that charge. *CFTC v. Equity Fin. Group,* No. 04-1512, 2007 WL 1038754 (D.N.J. March 30, 2007).

Thus, it has already been found that Firth and Shimer were operating and soliciting for an unregistered CPO and that, as fiduciaries to the Shasta investors, their actions and inactions perpetuated a fraud on those investors. The charges that remain to be tried deal mainly with whether the Defendants knew or were reckless in not knowing that they were defrauding their investors and allowing Equity to operate in an unregistered status. The evidence at trial will show both that the Defendants were reckless in ignoring the Ponzi scheme that they helped to perpetuate and that they fraudulently misrepresented and omitted material facts to Shasta's

investors.. The evidence will thus show that the Defendants are liable on the Commission's remaining charges that they violated §§4b(a)(2)(i)-(iii) and 4*o*(1)(A) of the Act, 7 U.S.C. §§ 6b(a)(2)(i)-(iii), 6*o*(1)(A) (2002) and that Shimer aided and abetted Equity's violation of 4m of the Act, 7 U.S.C. § 6m. The Commission will also show that Shimer and Firth are liable for Equity's violations of §§ 4b and 4m as control persons under Section 13(b) of the Act, 7 U.S.C. § 13c(b) , and that Defendant Equity, pursuant to Section 2(a)(1)(B) of the Act, 7 U.S.C. § 2(a)(1)(B), is liable for the violations of Firth and Shimer still to be tried because the actions and omissions of Firth and Shimer were done within the scope of their employment with Equity.

FACTS

Many of the facts in this case are not disputed and some have already been found by the Court. *See* Stipulated Facts in Joint Pretrial Order and CFTC SJ Decision. Thus, the Commission will not need to prove many of the facts set out below.

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. It was the manager of Shasta Capital Associates ("Shasta"), a Delaware limited liability company. Firth is the President and sole shareholder of Equity. Shimer was legal counsel to Equity and Shasta. The Commission asserts they were both controlling persons of Equity.

Firth has a background in real estate financing. The Shasta private placement memorandum ("PPM") touts Firth as a successful businessman. In actuality, he has filed for bankruptcy numerous times, including in 2003 when he was soliciting investors for Shasta. Shimer is an attorney and has been a member of the Massachusetts Bar since 1973. He also has long been familiar with the futures industry, as he was registered as an AP of a commodity pool

operator ("CPO") in 1986 and an AP of an introducing broker ("IB") in 1989. He took and passed the Series 3 examination required for APs in the futures industry in 1986. Although his name appears nowhere in the PPM, the facts already established and the facts that will be proven at trial show that Shimer controlled almost every aspect of Equity's relationship with Tech Traders and Murray, including the CPA verification process.

Shasta was a feeder fund to the Tech Traders' "super fund" master pool. Defendant Coyt Murray ("Murray") was the president and CEO of Tech Traders and was Tech Traders' primary contact person in dealing with potential participants. Shimer dealt extensively with him, calling him sometimes every day during their relationship. Murray and his Tech Trader companies (Tech Traders, Ltd. Tech Traders. Inc., Magnum Capital Investments, Ltd. and Magnum Capital Investments) have admitted that they committed intentional fraud under § 4b of the Act as well as other violations of the Act and Regulations. *See* Consent Order of Permanent Injunction and Other Ancillary Relief Against Defendants Tech Traders, Inc., Tech Traders, Ltd., Magnum Investments, Ltd., Magnum Capital Investments, Ltd. and Coyt E. Murray. (Docket Doc 514.) Moreover, the parties have all stipulated that Tech Traders was a Ponzi scheme –because they have stipulated that it received a total of $43,132,522.01 from Shasta and other investors, returned a total of $11,984,471 of principal to investors, paid $617,942.19 in fictitious profits to investors, and from 2001 to April 1, 2004, lost $7,605,407 million trading commodity futures contracts and other financial instruments in the accounts that held Shasta, and other third-party funds.

Murray and Tech Traders hired Defendant J. Vernon Abernethy ("Abernethy") to review and verify Tech Traders' trading results and supply a monthly rate of return number which was supplied to Equity and other third parties.[1] 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. 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.

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/. 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.

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[1]On July 7, 2006, the Court entered a consent order of permanent injunction against Abernethy that permanently enjoins him from further violations of Sections 4o(1), and 4k(2) of the Act; prohibits him from engaging in any customer or third party commodity-related activity or trading for his personal account; bars him from seeking registration or an exemption from registration with the Commission; compels him to comply with undertakings not to practice before the Commission as an accountant for a period of ten (10) years following entry of the Order, not to accept any engagement that involves the review or analysis of commodity pool statements, and not to accept any engagement that involves the analysis of futures or options statements; and requires him to pay $5,000,000 in restitution to Tech Trader's pool participants, and to pay a civil monetary penalty of $300,000. *See* Docket Doc. 377.

Between at least June 2001 and April 1, 2004, Equity, acting through Shimer and Firth, and Shimer and Firth individually, solicited and received $15,113,498.11 in outside investor funds for trading by Tech Traders in commodity futures contracts. Shimer and Firth also solicited $295, 143.81 from two New Century investors for participation interests in Tech Traders. 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 over $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.

B. Shimer and Firth Did Not Disclose Their Previous Failed Investment Experiences.

Before creating Shasta and soliciting over $15 million from investors, Shimer and Firth participated in numerous failed business dealings in which people they had solicited for investments lost money. They failed to disclose these past business failures and resulting debts to actual and prospective investors in Shasta.

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. 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. None of this information is disclosed in the Shasta PPM, which touts Firth as a

successful real estate financier.

Shimer also had been involved in at least three 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. 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.[2]

The third Kaivalya investment is connected to Coyt Murray. This investment was made through Jerry LaTulippe ("LaTulippe") and Tom Leonard ("Leonard") in the fall of 1999. LaTulippe told Shimer that he had an exclusive relationship with a trader who was obtaining phenomenal results trading the markets. That trader was Coyt Murray. In October, Shimer 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.

This third Kaivalya investment also failed. 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. Shimer therefore decided to try to find the trader LaTulippe and Leonard had claimed to give the $1.3 million to – Coyt Murray.

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[2] As the Defendants have stipulated and the claims process has revealed, some of these Kaivalya investors were repaid their principal investment through recycled funds Shimer obtained from Tech Traders and Murray.

C. The Defendants Recklessly Ignored Murray's Dubious Past and Agreed to Solicit Investors for his Trading System in Exchange for Secret Payments.

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** been trading before he met with Shimer in the fall of 2000, but 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. These inconsistent stories should have been a red flag to Shimer that Murray was not being honest with him about whether he had actually been trading his system in the past and whether that trading had been successful. Shimer ignored these red flags and did not ask Murray a lot of questions about his past trading history.

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 inexplicably agreed to help Shimer repay the Kaivalya investors. 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 some of the "profits" obtained through that trading with Shimer and Firth. 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[3], David Perkins.

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[3] Universe was a limited liability corporation formed to invest in Shasta. It had 40 investors who collectively invest $3.4 million in Shasta. The Commission has sued Perkins in a related action (Footnote continued)

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. .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.

Firth agreed to participate in the secret profit split with Murray and reviewed and approved the Shasta PPM which did not disclose the agreement. Under the Shasta 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, unbeknownst to Shasta's investors, Shimer and Murray agreed that 1/3 of the 15% that the PPM stated was going to Tech Traders for expenses (or 5% of the total "profits") was going back to Shimer and Firth. Also, ½ of Tech Traders' "profit" split (or 25% of the total "profits") was also credited to Shimer and Firth. Thus, though the PPM stated that the only compensation to the manager Equity was 5% of the profits and 1% for legal and accounting fees, in reality, Shimer and Firth were entitled to 35% of Tech Traders' "profits."

Shimer drafted an agreement to memorialize this secret profit split. 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%

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in this Court, alleging he was the unregistered CPO of Universe and misled Universe investors by failing to verify the accuracy of Shasta's results and disclose Perkins' involvement with Shimer in the failed Kaivalya deals,. *CFTC v. Perkins,* Civ. No. 06-4674 (September 26, 2006.)

share of any remaining "profits" to Shadetree. Although the agreement was ostensibly between Tech Traders and Shadetree, this was really just a legal smoke screen set up by Shimer to obfuscate a secret piggy bank he used to account for debts owed to Kaivalya, commissions owed to people who had solicited investors for Shasta, and provide gifts to friends and relatives with whom he wished to share his largesse. While a bank account in the name of Shadetree was never established, the Shadetree "profits" were accounted for on paper in an internal account styled "Shadetree" that Shimer and Firth kept track of on an Excel spreadsheet. As of March 1, 2004, this Shadetree "account" had a balance of $1,583,473.34. Although the Commission shut down the Tech Traders' Ponzi scheme before Shimer and Firth could collect all the secret "profits" accumulated in the Shadetree "account," Tech Traders did make payments of $1,314,930 pursuant to this account at Shimer's direction to a bank account in the name of Kaivalya that was under the control of Shimer. The Shadetree "account" was not disclosed in the Shasta PPM and was not otherwise disclosed to Shasta investors or potential investors.

When Shimer began soliciting potential investors for Murray's trading system, he found that investors wanted more information than Shimer's representations that Murray had a phenomenal trading system. Sophisticated investors, in particular, wanted to know how much money Murray and his company Tech Traders had in trade, how much he had made in profits and through which futures commission merchant ("FCM") he traded. However, Murray did not want to reveal this information to anyone. Shimer therefore began to develop an investment structure to deal with Murray's reluctance to give information about his trading system and its performance.

Shimer 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 particularly in light of the fact that 2001 was a "post Enron" environment.

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. 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. Shimer drafted the PPM, which was reviewed and approved by Firth. 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.

D. Defendants Recklessly Set Up a Flawed System for Verifying Tech Traders' Performance.

Shimer and Firth knew that investors would want some assurance that an investment in Shasta was sound. Because Murray would not share with investors or potential investors how much money he had under management, what futures commission merchants ("FCMs") he

traded through or provide access to brokerage statements[4], that would indicate whether his system actually generated profits, Shimer devised the idea of verification of trading results by a CPA to provide investors a level of comfort. This comfort was illusory, however. Shimer acquiesced in conditions Murray put on the verification procedure that made it more likely to be flawed, insisted on a simplistic formula to determine the rate of return that was ambiguous and did not consider key information. H e also relied on two inexperienced accountants who were not independent and were subject to undue influence. Firth recklessly left the entire process in the hands of Shimer, even though he was not comfortable with Abernethy, and knew the accountant was soliciting for Shasta.

Shimer initially selected Teague to perform the verification process. He suggested to Murray that she receive brokerage statements straight from the FCMs, and review the profit or loss number provided by the FCMs. However, Murray did not want to allow the FCMs to send Teague duplicate statements. He did not want Teague to receive statements at all. Murray preferred that he hire his own accountant. He also did not agree to allow his own accountant to receive duplicate statements but would only agree to provide the statements to the accountant. Thus, because the statements were not coming from a third party, but from Murray himself, it was possible to manipulate the information that accountant received.

Murray also did not want his CPA to talk to investors. Therefore, because Shimer wanted an accountant to speak to investors to provide them comfort that the trading results were CPA verified, he kept Teague involved in the process. But her involvement in the process only

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[4] During the time it accepted Shasta funds, Tech Traders traded commodity futures contracts through multiple trading accounts at four FCMs. 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 Brief.

added an unnecessary level of complexity with the potential to mislead investors. The process that Shimer orchestrated to provide comfort to investors while meeting Murray's requirements was to have Teague accept a rate of return number from Abernethy and plug it into a "Verification" Letter of her own to Firth without any analysis or review of her own. Because she added no value to the process, her availability to talk to investors was a meaningless gesture that only confused investors.

Shimer also abandoned the idea of looking at the profit and loss numbers provided by the FCM on the brokerage statements. Instead, although he had no experience in performing rate of return calculations, Shimer agreed with Murray to calculate the rate of return according to a formula Shimer set out in Investment Agreement between Shasta and Tech Traders. The formula was set out in a section of the contract entitled " 'Profit' and 'Profits' Defined." Shimer believed this calculation, which involved subtracting the beginning balance in the brokerage account from the ending balance and dividing the difference by the beginning balance, was something so simple any 6th grader could perform the calculation. However, his formula did not set out how to treat additions and withdrawals from the brokerage accounts. It also did not account for all of the assets and liabilities of the superfund or commodity pool but looked solely at brokerage accounts.

Teague gave Shimer information that should have caused him to 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 whose 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. As the Commission's expert, NFA Compliance Manager Susan Koprowski will testify, CFTC approved methods all properly account for additions and withdrawals. Shimer's method does not address how to consider additions and withdrawals, thus leaving open the possibility that additions and withdrawals could improperly skew performance results.

Shimer also ignored information that the CPA verification he wanted was specialized work that should not be done by someone who did not have experience calculating performance for commodity pools or other types of passive investments. Teague had told him she did not have experience in the field. When Murray sought out an accountant to do the work, his longtime accountant, Robert Collis, declined the engagement because of concerns that the business Tech Traders was in might need to be registered under the securities law, his firm did not have the expertise to verify performance returns for an investment and the CPA firm's insurer would require an extra premium to cover the engagement. Shimer called Collis and tried to persuade him to take the engagement anyway, insisting that it was simple work. Collis still declined and told Shimer why.

Murray then selected a local CPA who had an office in the same complex as Tech Trader's – J. Vernon Abernethy. Abernethy had never calculated the performance of an investment before either and told Shimer and Murray that. Abernethy was eager to take on the engagement anyway though because he was heavily in debt. When Shimer met him shortly after he was selected in July 2001, Abernethy was in the process of moving out of his office because of a divorce from his wife and partner in their CPA practice. She had taken most of the practice with her and Abernethy had to build his practice back up again. 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. Shimer and Firth were quite willing to mine prospects with Abernethy, even after some of those prospects questioned why the supposedly "independent" accountant was so eager to sell them the investment he was supposed to be verifying.

Shimer's formula for verifying a rate of return was also flawed because it required only a review of brokerage statements and did not specify what kind of brokerage statements should be reviewed. In order to properly perform a rate of return calculation, a person should have available, in addition to brokerage statements, 1) cash receipts and disbursements journal, general ledger, and bank statements and other documents relevant to income and expenses. Abernethy was not given full access to Tech Traders' records. Murray controlled what he received to review. Abernethy also did not know what documents he should be looking at and accepted from Murray trading statements that were not month-ends and thus did not show additions and withdrawals to the account. Thus, his review 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.

Neither Firth, Shimer nor Teague specifically knew what documents and figures Abernethy was reviewing to arrive at the rates of return he reported. 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.

However, Shimer knew that Abernethy did not have full access to the records necessary to compute an accurate rate of return. In November, 2001, Shimer revised a draft Verification Letter from Puttman & Teague to Equity to include explicit language that 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. Shimer sent this draft letter to Abernethy at Abernethy's request. Abernethy crossed out the language in the draft Verification Letter that stated he was granted full access to records and original brokerage statements. He replaced it with language which stated that "Shasta Capital Associates 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.

Thus, the Verification Letter that Teague sent each month to Equity 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.

After Abernethy and Teague were hired, they had very little contact with each other. 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. 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.

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 had very few dealing with Teague either. He relied entirely on Shimer to handle that process.

Shimer and Firth were thus reckless in not assuring that a proper method for determining a rate of return was followed. They were also reckless in relying on Teague and Abernethy, who were not experienced in this area, and in failing to assure that Abernethy had access to the records necessary to perform the proper calculations.

E. It was Reckless for Shimer To Create Tech Trader's Statements to Shasta and For Firth to Allow Him to Do So.

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 by Shasta's members 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.

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, and Abernethy's rate of return number 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 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.

F. Shimer and Firth's Acceptance of a Minimum Account Verification that was Less Than Tech Traders' Total Balance was Reckless.

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.

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.

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.

There were other red flags surrounding this minimum account verification. Abernethy did not want to provide this balance verification at all and repeatedly told Shimer he would not do so. As this should have been a simple task, as Shimer acknowledges, Abernethy's refusal to provide it should have told Shimer something was amiss with the verification process. Teague also thought a verification of the whole amount should be a simple process for Abernethy, as she thought Abernethy had access to all necessary records.

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, at Murray's insistence, to only 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 four of those seven months, the amounts he verified were **lower** than the amount Shasta's statements reflected Shasta had invested in Tech Traders. For all seven months, the amounts Abernethy verified were lower than the combined balances that the Shasta, New Century and Shadetree statements reflected -- all statements that Shimer prepared. 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.

G. 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 should have been registered. 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. The issue of whether Shasta had to register as a CPO with the CFTC first came up in the fall of 2001 when Shimer had Firth send a copy of the Shasta PPM to an attorney friend, Andre Alonzo, who had contacts with sophisticated corporate investors. Alonzo sent the PPM to a client named "Chuck" who worked for Chase Manhattan Bank. "Chuck "asked Alonzo if Shasta was required to register with the CFTC. Shimer then wrote a memorandum that wrongly concluded that Shasta did not have to register as a CPO. Shimer forwarded the memorandum to Alonzo who allegedly forwarded it to "Chuck" who forwarded it to Chase's legal department. Shimer then supposedly received a verbal response through Alonzo that "Chuck" had told him Shasta did not have to register. Despite this third-hand verbal feedback no one from Chase invested in Shasta. Despite the fact that he had received no written opinion or even talked to the person who allegedly reviewed his memorandum, Shimer did nothing more to in 2001 or 2002 determine if his analysis was correct.

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 October 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. 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. 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.

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.

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. They told Shimer that they could not understand why Tech Traders was dragging its feet in obtaining counsel and dealing with the regulatory concerns. 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. Therefore, Shimer and Firth ignored the information Arnold & Porter gave them and continued to operate Shasta without registration. Shimer and Firth brought in over $8.5 million of investor money from the time Arnold & Porter warned them that they could be charged with running an illegal commodity pool and that they could be aiding and abetting Tech Traders' running of an illegal commodity pool until the fraud was shut down by the CFTC's action.

ARGUMENT

A. The Defendants' Material Misrepresentations and Omission to Shasta Investors Violated Section 4b(a)(2) of the Act.

A violation of Section 4b of the Act exists when the Commission demonstrates: (1) a misrepresentation on the part of the defendant; (2) that is material, and (3) made with scienter. *CFTC v. R.J. Fitzgerald,* 310 F.3d 1321, 1328 (11th Cir. 2002), *reh. denied* (April 12, 2004), *motion to stay mandate pending cert.* (April 20, 2004); *Slusser v. CFTC*, 210 F.3d 783, 786 (7th Cir. 2000) (reliance by customers is not necessary for a 4b(a) violation); *Hammond v. Smith Barney Harris Upham & Co.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,617 at 36,659 (CFTC Mar. 1, 1990) (scienter is a necessary element of proof for a violation of Section 4b(a) of the Act).

A statement is material if "there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision." *Saxe v. E. F. Hutton & Co., Inc.*, 789 F.2d 105, 109 (2nd Cir. 1986); *see also R.J. Fitzgerald,* 310 F.3d at 1329-30; *CFTC v. Rosenberg*, 85 F. Supp. 2d 424, 447 (D.N.J. 2000) (misrepresenting an account balance, profit potential or risk is material); *CFTC v. Noble Wealth Data Info. Serv., Inc.*, 90 F. Supp. 2d 676, 686 (D. Md. 2000) , *aff'd in part, vacated in part, sub nom. CFTC v. Baragosh*, 278 F.3d 319 (4th Cir. 2002). Such actionable misrepresentations include those made to investors when soliciting their funds. *Rosenberg*, 85 F. Supp. 2d at 447-448; *Saxe,* 789 F.2d at 110-111; *Hirk v. Agri-Research Council Inc.*, 561 F.2d 96, 103-104 (7th Cir. 1977) (misrepresentations regarding the trading record and experience of firm or broker are fraudulent because past success and experience are material factors to reasonable investors). In general, all manners of omissions and misrepresentations of material fact regarding futures and options transactions – such as omissions and misrepresentations concerning the likelihood of profit, risk of loss, payment of

fees and commissions, and other matters that a reasonable person would consider important to his decisions – violate the anti-fraud provisions of the Act and regulations. *R.J. Fitzgerald,* 310 F.3d at 1329-30; *Noble Wealth*, 90 F. Supp. 2d at 686 (representations about profit potential and risk "go to the heart of a customer's investment decision" and are therefore material as a matter of law).

The misstatements that the Defendants made on the Shasta website, in the Shasta PPM and in investor statements that Tech Traders' trading was profitable and that its trading results had been verified by an independent accountant were material to Shasta investors. Firth's and Shimer's history of involvement in failed investment schemes involving other people's money was also material information that Shasta's investors had a right to know, as was the secret Shadetree profit sharing agreement.[5]

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[5] Any kind of fees, including any agreements or understandings to receive distributions of profits greater than a person's pro rata share based on his/her contributions to a commodity pool have to be disclosed to investors under Regulation 4.24(i). 17 C.F.R. § 4.24(i) (2006). Information required to be disclosed pursuant to Commission regulations is *per se* material and the Commission has often held that the failure to disclose a fee arrangement is a fraudulent omission. *In re Slusser*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep (CCH) ¶ 27,701 at 48,305, 48,312 (CFTC July 19, 1999), *aff'd*, *Slusser v. CFTC*, 210 F.3d. 783, 786 (7th Cir. 2000). In *Slusser,* the Commission held that an introducing broker's failure to disclose that it had received commissions is a fraudulent material omission, where its prospectus said that its compensation would be limited to receiving a percent of profits. In the context of commodity options fraud, the Commission stated in *In re Rosenthal & Co.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep (CCH) ¶ 22,221 at 29,163, 29,177 (CFTC June 6 1984): "[W]e now hold that the omission to disclose fees and commissions is material, that the firm's sales agents violated Regulation 32.9 each time they failed to disclose commissions and fees in their telephone sales presentations to customers, and that the firm is liable as a principal for these violations by its agents." In *In re Citadel Trading Co. of Chicago, Ltd.*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep (CCH) ¶ 23,082 at 32,182, 32,185 (CFTC May 12, 1986), the Commission held that a registered CTA and AP of an FCM had violated Sections 4b and 4o by soliciting accounts through deceptive means, including "failing to disclose material facts such as his commission-sharing arrangements" with the FCM, where "especially his failure to disclose his commission arrangement ... w[as] material." Id. at 32,187-88. In *In re JCC, Inc.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep (CCH) ¶ 26,080 at 41,568, 41,576 and n.23 (CFTC May 12, 1994), *aff'd*, 63 F.3d 1557 (11th Cir. (Footnote continued)

The Commission must also establish that Shimer and Firth's material misstatements and omissions were made with scienter. Scienter may be established by showing that: (1) the defendant knew his misrepresentations were false and calculated to cause harm; or (2) the defendant made the representations with a reckless disregard for their truth or falsity. *Drexel Burnham Lambert Inc. v. CFTC*, 850 F.2d 742, 748 (D.C. Cir. 1988) (respondent acted in willful disregard of whether he was acting in accordance with his instructions). *See also First Commodity Corp. of Boston v. CFTC*, 676 F.2d 1, 7 (1st Cir. 1982) ("[T]he Act authorizes the Commission to predicate liability for fraud in foreign futures transactions on a reckless state of mind"); *CFTC v. Savage*, 611 F.2d 270, 283 (9th Cir. 1979) ("Knowledge . . . exists when one acts in careless disregard of whether his acts amount to cheating, filing false reports, etc. . . . [and] cannot be precluded by ignorance brought about by willfully or carelessly ignoring the truth"); *CFTC v. American Metals Exchange Corp.*, 775 F. Supp. 767, 778 (D.N.J. 1991), *aff'd in part, vacated in part,* 991 F.2d 71 (3rd Cir. 1993) (defendant who participated in sale of illegal futures contracts and was in daily contact with company committing fraud participated with reckless disregard for his duties under the Act). The Commission need not prove that the defendants possessed an evil motive or intent to injure a customer, or that they did not subjectively want to cheat or defraud their customers. *Cange v. Stotler & Co. Inc.*, 826 F.2d 581, 589 (7th Cir. 1987); *Lawrence v. CFTC*, 759 F.2d 767, 773 (9th Cir. 1985) ("Proof of an evil motive is unnecessary"). "It is enough that he acted deliberately." *Haltmier v. CFTC*, 554 F.2d 556, 562 (2nd Cir. 1977).

1995), the Commission held that the solicitation activities of an FCM misled customers about material elements of the investment program, such as the size of the management fee.

The Court has already found that Shimer and Firth had fiduciary duties to Shasta's investors. CFTC SJ Decision at 16,18. As set out above, they acted with reckless disregard of those duties in soliciting over $15 million from investors. Firth was reckless because, though he claimed in the PPM to conduct due diligence in investigating the soundness of the Tech Traders' investment and touted the CPA verification of it, he did nothing to assure the investment was sound. Shimer was reckless because he insisted on using a simplistic formula for determining a rate of return on the Tech Traders trading system when he had no experience in the area and was warned that the process was not that simple. Also, though he was in almost daily contact with Murray, he ignored the repeated red flags that Murray was hiding vital information. Based just on their recklessness Shimer and Firth violated § 4 b.

However, Shimer and Firth not only recklessly reported trading results that were "too good to be true," they knew that several aspects of their solicitations were objectively false. They made both affirmative representations they knew were untrue and failed to disclose material information that would have been important to a reasonable investor. For instance:

1. The PPM, which Shimer drafted and Firth reviewed and approved states that Firth was a successful businessman, when they knew that Firth had prominent business failures, had filed for bankruptcy three times, and had been involved in a business where customers' funds had been misappropriated;
2. The PPM stated that Firth held an NASD Series 7 license, whish was not only false but implied a level of investment knowledge when Firth actually had no experience with commodity trading or commodity pools;
3. The PPM did not disclose Shimer's role at all or the fact that he created the Shasta pool to obtain funds to pay off Kaivalya investors, some of whom were threatening to sue him;
4. The PPM stated that Equity was entitled to only a one-time 1% legal and administrative fee and a 5% management fee and did not disclose the secret "profit" sharing arrangement Shimer and Firth had with Murray by which they took 35% of the Tech Trader "profits"; and
5. The PPM also stated that the "local" CPA was independent, when Shimer and Firth knew to the contrary because they engaged in solicitation activities with Abernethy.

Firth and Shimer also made or caused to be made representations intended to mislead potential and actual participants. For example, Firth and Shimer stated in the PPM that investors

could call their CPA (Teague) to find out if the balance of funds held by Tech Traders exceeded or did not exceed Shasta's deposits to Tech Traders. However, they knew that Tech Traders had commingled Shasta's funds with the funds of others, and specifically knew that the balance of funds verified by Abernethy was meaningless in the absence of verification that Tech Traders held sufficient funds to repay all claims against the "super fund" – and they knew Murray would not provide that separate verification. Similarly, Shimer and Firth also represented in the PPM that Equity had retained at Shasta's expense a second independent CPA "for the purpose of verifying the profitability of Shasta's investment with the trading company." However, all Teague did was to receive the rate of return figures and restate them. Moreover, Shimer and Firth did not allow investors to talk to Abernethy or even provide his name to investors but made Teague available to respond to potential and actual participants to allay concerns about the pool. This provided false assurance to investors that returns were legitimately being verified.

B. Defendants Violated Section 4*o*(1)(A) of the Act.

Section 4*o*(1) of the Act, in two provisions, broadly prohibits fraud and misrepresentation by CTAs, CPOs and their APs. The Court has already found that Defendants violated Section 4*o*(1)(B) of the Act, which 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. *See* CFTC SJ Decision at 16,18. 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. The same conduct that violates Section 4b can violate Section 4*o*(1). *Stotler & Co. v. CFTC*, 855 F.2d 1288, 1290-91 (7th Cir. 1988); *CFTC ex rel Kelley v. Skorupskas*, 605 F.Supp. 923 (E.D. Mich.

1985). Therefore, as the Defendants are liable under Section 4b, they should be held liable under Section 4*o*(10(A) as well.

C. Shimer Aided and Abetted Equity's Violation of Section 4m(1).

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. The Court has already found that Equity was a CPO and that it violated Section 4m(1) by failing to register. *See* CFTC SJ Decision at 7. The question remaining to be decided is whether Shimer aided and abetted that violation.

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).

It has already been established that the Act was violated and that Shimer intentionally assisted that violation 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. The evidence also establishes that he had the

requisite knowledge that Equity was a CPO. He is a lawyer. Although being a lawyer does not make one automatically knowledgeable about all laws, Shimer had a unique background that gave him exposure to the commodities industry and the Commodity Exchange Act. He had taken the Series 3 examination and been registered as an AP of a CPO before. Thus, he knew enough about the Act to tell Murray during the formation of Shasta in the spring and summer of 2001 that Tech Traders might be required to register as a CPO because it was taking in investor funds. When a prospective investor questioned Shasta's registration status in the fall of 2001, he researched the regulations governing the registration of commodity pools. Thus, he had the information that showed that Equity should be registered as a CPO. He then deliberately misread the law and misapplied the facts to reach a conclusion that was in accord with his own self interest in continuing the Tech Traders/Shasta venture. His passing of the memorandum through several hands to receive verbal hearsay that registration was not required hardly constitutes a legal opinion that his analysis was correct.

Assuming that Shimer's research on registration requirements in 2001 was just bad lawyering and that he really thought based on his analysis that Equity did not need to register as a CPO, he certainly knew by October 2003 that Equity was required to register. His actions at that time also cast doubt on his confidence in his earlier analysis. When another prospective investor, Mark Munson, questioned Equity's registration status again, Shimer hired Arnold & Porter. (He did not just rely on his earlier analysis.) Two experienced commodities lawyers from Arnold & Porter told him in their first conversation 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. Arnold & Porter also reviewed Shimer's legal analysis, which Shimer updated in 2003, which concluded that Shasta was not a commodity

pool because it was not directly trading commodity futures contracts and told him that the firm disagreed with that analysis. 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.

Arnold & Porter told Shimer in their first conversations that Equity might qualify for an exemption from registration as a fund-of-funds if Tech Traders was in regulatory compliance.[6] However, the firm needed to know more about Tech Trader's structure to complete its analysis. Arnold & Porter told Shimer and Firth that because Shasta's registration requirements hinged on Tech Trader's registration requirements, it was advisable to go to the CFTC with Tech Traders to cure regulatory deficiencies. They also told Shimer that Shasta and Tech Traders should go to the CFTC as quickly as possible to cure its regulatory deficiencies.

However, Murray told Shimer he did not share the sense of urgency and did not take steps to meet with the CFTC to cure the registration defects. Arnold & Porter sent both Shimer and Firth repeated emails and memoranda warning that Shasta was subject to charges that it were running an illegal and unregistered commodity pool. These repeated oral and written statements by Arnold & Porter gave Shimer the knowledge that Equity should be registered as a CPO. Still, Shimer did nothing to bring Equity into regulatory compliance.

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[6] Shimer understood that Equity would have to file for an exemption if it qualified for one, or it would not be incompliance with registration requirements.

D. 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. R.J. Fitzgerald, Inc.*, at 1334. A "fundamental purpose" of the statute is "to reach behind the corporate entity to the controlling individuals of the corporation and to impose liability for violations of the Act directly on such individuals as well as on the corporation itself." *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. 2002) *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); *CFTC v. AVCO Financial*

Corp., 28 F.Supp.2d 104 at 117 (S.D.N.Y. 1998), *aff'd in part, rev'd and remanded in part,sub nom. CFTC v. Vartulli,* 228 F.3d 94 (2d Cir. 2000)..

Firth has admitted that he is a controlling person of Equity. Firth both knowingly induced and failed to act in good faith with respect to Equity's violations of §§ 4b, 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, Shimer or the accountant verification process. 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 repeated warnings that Shasta was an illegal commodity pool. As the president of Equity, the manager of Shasta, he had a fiduciary duty to Shasta's investors to assure that Shasta's investment was sound and that it was in regulatory compliance. His failure to do so was reckless and in bad faith. *See In re First Nat'l Trading Corp.,* Comm. Fut. L. Rep. (CCH) ¶25,813 (CFTC Aug. 24 1993) (holding that President and CEO of corporation lacked "good faith" supervision when he was responsible for establishing, maintaining, and enforcing a meaningful compliance system, including insuring that the compliance officer performed compliance duties properly, yet he abrogated these supervisory responsibilities). 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, and the evidence shows, was involved in every aspect of Shasta's investment with Tech Traders. Shimer conceived Shasta and determined how it would be structured, 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 in almost constant contact with Murray.. His actions in ignoring the repeated warning signs that Murray's operation was not legitimate and in ignoring Arnold & Porter's repeated warnings that Equity was operating an illegal commodity pool show his recklessness and lack of good faith. *See Monieson v. CFTC,* 996 F.2d 852, 860-61 (7th Cir. 1993) (holding that Chairman of the Board acted recklessly in not supervising the company's supervision system with reasonable diligence where he never took any solid step towards investigating the many warnings he received that two brokers were placing trades without account identifications and were frequently allocating trades.) Therefore, Shimer should also be held liable as a controlling person of Equity under Section 13(b) of the Act.

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

Section 2(a)(1)(B) of the Act, 7 U.S.C. § 2(a)(1)(B) (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).

RELIEF REQUESTED

I. 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 Court has already found several violations of the Act here by all Defendants and the evidence will show that the Defendants are liable for the remaining charges the Commission has brought against them. 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 and then to solve that problem, created Shasta to obtain

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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.

the secret "profits" through Shadetree to pay back Kaivalya investors, set up a faulty formula for verifying trading results to entice new investors and ignored red flags that would indicate Tech Traders was a fraud. Firth solicited investors to invest over $15 million without doing any due diligence on the investment, even though he had previously lost investor money, 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 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, and their failure to accept any responsibility for the fraud they helped perpetrate, 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.[8]

II. 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"),

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[8] As the Commission set out in its First Amended Complaint, the Defendants should be permanently enjoined from a) engaging in conduct in violation of Sections 4b(a)(2), 4k, 4m(1) and 4*o*(1) of the Act, b) directly or indirectly soliciting or accepting any funds from any person in connection with the purchase or sale of any commodity futures or options contract; c) engaging in, controlling, or directing the trading of any commodity futures or options accounts, on their own behalf or for or on behalf of any other person or entity, whether by power of attorney or otherwise; d) introducing customers to any other person engaged in the business of commodity futures and options trading; e) issuing statements or reports to others concerning commodity futures or options trading; and f) otherwise engaging in any business activities related to commodity futures or options trading.

citation omitted; *CFTC v. U.S Metals Depository Co.*, 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.* at 693 , *aff'd in part rev'd in part on other grounds*, *CFTC v. Baragosh,* 278 F.23d 319 (4th Cir. 2002) *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 plans to Shasta investors, including Universe. *See Order Dated 9/26/05* [Document 257.]; *Order Dated 10/27/05* [Document 279]; *Order Dated 03/10/06* [Docket Document 329]; *Order Dated 04/16/06* [Document 346]; *Order Dated 04/17/06* [Docket Document 348]; and *Order Dated 04/25/06* [Docket Document 354]. 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 estimated at $5,078,603.26. Equity, Shimer and Firth should be ordered to pay this shortfall to the Shasta investors, plus prejudgment interest of $1,134,934.46 for a total of $6,213,537.72.[9] *Skorupskas*,

[9] The restitution amount cannot be fixed until the Receiver's final distribution because it 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.

605 F.Supp. at 943 (ordering distribution of assets gained from fraudulent solicitation of investors).

Equity, should also be ordered to disgorge the payments it received from Tech Traders as management fees and Shimer and Firth should be ordered to disgorge the amounts they received from Equity and pursuant to the secret profit splitting arrangement they had with Murray. Equity obtained $612,500; Shimer profited from this scheme in the amount of $1,452,117 and Firth profited by $450,313. Thus, Equity should disgorge $612,500 plus prejudgment interest of $ $136,877.66, for a total of $ 749,377.66. Shimer should disgorge $1,452,117, plus prejudgment interest of $324,510.02, for a total of $1,776,627.02. Firth should disgorge $450,313 plus prejudgment interest of $100,633.13, for a total of $550,946.13.

III. 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 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, to Firth was $450,313 and to Shimer was

[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.

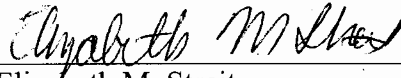
$1,452,117. Triple those amounts are: Equity $1,837,500;Firth: $1,350,939 and Shimer: $4,356,351 . Civil penalties in these amounts are warranted here. Such civil penalties are particularly appropriate here where these gains were appropriated from investor funds and, in part, pursuant to a secret profit sharing arrangement with Tech Traders that was not disclosed to the investors.

CONCLUSION

The evidence already established in this case, as well as the evidence that will be established at trial amply demonstrates that Shimer and Firth have violated §§ 4 b, 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 §§4b, 4m and 4*o* as controlling persons and Equity is liable as principal for Shimer's and Firth's §§4m, 4*o* and 4k violations. Therefore, this Court should grant a permanent injunction on those charges, enjoin Defendants from soliciting for commodities trading or engaging in commodities trading or other commodities activities and impose a restitution award against Equity, Shimer and Firth, jointly and severally, in the amount of $5,078,603, plus prejudgment interest of $1,134,934.46 for a total of $6,213,537.72. The Court should also order Equity to disgorge $612,500 plus prejudgment interest of $ $136,877.66, for a total of $ 749,377.66; Shimer to disgorge $1,452,117, plus prejudgment interest of $324,510.02, for a total of $1,776,627.02 and Firth to disgorge $450,313 plus prejudgment interest of $100,633.13, for a total of $550,946.13. Finally, the Commission requests that the Court order civil monetary penalties of $1,837,500 against Equity, $4,356,351 against Shimer and $1,350,939 against Firth.

Date: August 20, 2007

Respectfully submitted,



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