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Commodity Futures Trading Commission v. Lake Shore Asset Management Limited, et al.
CASE No. 07C-3598

CFTC Renewed Application for Entry of a Default Judgment Order
Resolving All Outstanding Issues,
Including Imposition of Restitution and Civil Monetary Penalty

Filed October 31, 2011

**In The United States District Court
For The Northern District Of Illinois
Eastern Division**

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

**CFTC'S RENEWED APPLICATION FOR ENTRY OF A DEFAULT JUDGMENT
ORDER RESOLVING ALL OUTSTANDING ISSUES, INCLUDING IMPOSITION OF
RESTITUTION AND CIVIL MONETARY PENALTY**

Pursuant to Rule 55(b)(2) of the Federal Rules of Civil Procedure ("Fed. R. Civ. P."), Plaintiff Commodity Futures Trading Commission ("Commission") respectfully submits this application to the Court to enter a default judgment order of restitution against Defendants Lake Shore Asset Management Limited ("LSAM"); Philip Baker ("Baker"); Lake Shore Group of Companies, Inc., Ltd ("Lake Shore Group"); Lake Shore Alternative Financial Asset Account Ltd. a/k/a Lake Shore Alternative Financial Asset Ltd. ("LS Acct" or "LS Asset"); Lake Shore Alternative Financial Asset Account 1 Ltd.; ("LS Acct 1"); Lake Shore Alternative Financial Asset Account II Ltd.; ("LS Acct 2"); Lake Shore Alternative Financial Asset Account III Ltd. ("LS Acct 3"); Lake Shore Alternative Financial Asset Fund Ltd. ("LS Fund 1"); Lake Shore Alternative Financial Asset Fund II Ltd. ("LS Fund 2"); Lake Shore Alternative Financial Asset Fund III Ltd. ("LS Fund 3"); Lake Shore Alternative Financial Asset Fund IV Ltd., currently known as Geneva Corporation Funds World Ltd. ("LS Fund 4"); Lake Shore Alternative Financial Asset Fund IV US, LLC ("LS Fund 4 -US"); Lake Shore Alternative Financial Asset Yen Fund 1 ("Yen Fund 1"); Lake Shore Alternative Financial Asset Yen Fund Limited Class II ("Yen Fund 2"); Lake Shore Alternative Financial Asset Yen Fund Limited Class III ("Yen Fund

3”); and Hanford Investments Ltd. (“Hanford”) (collectively “Defendants” or “LS Common Enterprise”). The Commission also requests that this Court enter an order assessing a civil monetary penalty (“CMP”) against Defendants Baker and LSAM. In support of this Application, the Commission states as follows:

1. On February 19, 2008, the CFTC filed a Second Amended Complaint seeking injunctive and other equitable relief against additional entities and commodity pools controlled by Baker, including entities found in various foreign jurisdictions, because the additional entities and commodity pools, LSAM, Lake Shore Group and Baker, acting in concert with each other as a common enterprise, violated the anti-fraud provisions of the Commodity Exchange Act as amended (the “Act”), by misappropriating over \$11 million in pool participant funds, fraudulently soliciting pool participants and issuing false account statements to pool participants. The Second Amended Complaint also alleged that Defendants LSAM and Baker violated the record keeping and inspection provisions of the Act and Commission Regulations. (Dkt. 431)

2. On April 14, 2008, the CFTC filed a Consolidated Motion for Default Judgment (Dkt. 537) against fourteen commodity pools and entities operating as a common enterprise controlled by Baker (“Default Defendants”). On April 24, 2008, this Court entered a Default and Permanent Injunction Order against the Default Defendants which permanently enjoined them from further fraudulent conduct and from trading commodity futures. (Dkt. 552) In that Order, this Court found that the Default Defendants, operating as part of the LS Common Enterprise, violated the anti-fraud provisions of the Act by: i) misappropriating \$11.3 million of pool participant funds; ii) misrepresenting the profits and losses of the commodity pools they operated; iii) failing to disclose to pool participants the trading losses and other material facts

relating to the commodity pools; and iv) causing false statements to be issued to pool participants. (Dkt. 552)

3. On May 13, 2008, the CFTC filed a Motion for Sanctions against LSAM for its Failure to Comply with the Court's Order dated March 25, 2008, and a Memorandum of Law in Support thereof. (Dkts. 561 and 563) CFTC's Motion for Sanctions requested that the Court strike LSAM's Amended Answer to the Commission's Second Amended Complaint and enter a default judgment against LSAM. On June 10, 2008, this Court entered a partial default judgment against LSAM for failing to produce its books and records to the Commission, for violating numerous court orders, including the preliminary injunction and Receivership Order, and for flatly refusing to comply with an order compelling discovery under Fed. R. Civ. P. 37. (Dkt. 578) In particular, this Court determined that LSAM not only flouted court orders and refused to participate in discovery, but took affirmative acts to hide its books and records. Based on the egregious nature of LSAM's actions to date, a sanction other than a default judgment would not be tailored to the facts of this case. Accordingly, this Court struck LSAM's Amended Answer to the Commission's Second Amended Complaint. (Dkt. 578)

4. On September 17, 2008, this Court entered a Default Judgment and Permanent Injunction Order against Baker, which permanently enjoined him from further fraudulent conduct and from trading commodity futures. (Dkt. 597) In that Order, this Court found that Baker, as controlling person of the LS Common Enterprise, violated the anti-fraud provisions of the Act by operating a common enterprise that defrauded and deceived pool participants by misappropriating over \$11 million of their funds, misrepresenting the profits and losses of the pools, failing to disclose trading losses and other material facts relating to the pools, and causing false statements to be issued to pool participants. This Court also found that LSAM violated the

recordkeeping and inspection provisions of the Act and that Baker, as LSAM's controlling person, also violated those provisions. (Dkt. 597)

5. On May 11, 2009, this Court entered a Default Judgment and Permanent Injunction Order against LSAM, which permanently enjoined LSAM from further fraudulent conduct and from trading commodity futures. (Dkt. 652) In that Order, this Court found that LSAM, a registered commodity pool operator ("CPO") and commodity trading advisor ("CTA"), operating as part of the LS Common Enterprise, defrauded and deceived pool participants by misappropriating over \$11 million of their funds, misrepresenting the profits and losses of the pools, failing to disclose trading losses and other material facts relating to the pools, and causing false statements to be issued to pool participants. This Court also found that LSAM violated the recordkeeping and inspection provisions of the Act.

6. In the foregoing default judgment orders, this Court reserved the issues of whether the Defendants should be ordered to pay restitution and civil monetary penalties.

7. On March 30, 2010, the CFTC filed an Application for Entry of a Default Order Resolving All Outstanding Issues, Including Imposition of Restitution and Civil Monetary Penalty, a Memorandum of Law in support thereof and a Proposed Order. (Dkt. 791). This Court allowed the CFTC to withdraw the foregoing pleadings without prejudice, because they were filed prematurely, *i.e.*, before the Seventh Circuit Court of Appeals ruled on appeals filed by two claimants in this litigation, Andorra Bank Agricola Rieg S.A. ("Andbanc") and GAMAG Black & White Ltd. ("GAMAG") (Dkt. 808).

8. On May 11, 2011, the Seventh Circuit issued an opinion affirming this Court's denial of Andbanc's late claim and GAMAG's priority claim, and on July 19, 2011, the appellate court entered a mandate, affirming the judgment of this Court. (Dkt. 886).

9. Because the foregoing appeals are resolved, the Commission now renews its request for a default judgment order of restitution against all Defendants and an order assessing a CMP against Baker and LSAM.

10. While the specific language of Section 6c of the Act does not mention restitution, federal courts uniformly have recognized that the authority granted by Section 6c(d)(1) of the Act also permits courts to order appointment of a receiver, disgorgement, restitution, and other relief to comply with the basic objectives of the Act. *CFTC v. Hunt*, 591 F.2d 1211, 1222-23 (7th Cir. 1979); *CFTC v. Co Petro Marketing Group*, 680 F.2d 566, 583 (9th Cir. 1981).

11. The Commission believes that the objectives of the Act are best served in this case by ordering full restitution to all Lake Shore customers to compensate them for the Defendants' wrongful acts. According to the Declaration of Brick Kane, the Chief Operating Officer of Robb Evans & Associates, the court appointed Receiver, the net investor claims filed with the Receiver totaled \$274,148,513.40 (total customer deposits of \$291,860,626.25 less total pre-receivership payments of \$17,712,112.85). Thus, the total amount of restitution owed to defrauded customers is \$274,148,513.40. See Kane Declaration, attached hereto as Exhibit 1.

12. The Commission requests that this Court enter an order finding the Defendants jointly and severally liable for restitution to defrauded Lake Shore customers in the amount of \$274,148,513.40. The proposed Order gives Defendants a dollar-for-dollar credit against their restitution obligation to the extent that the Receiver is successful in recovering and distributing Receivership assets to Lake Shore's pool participants pursuant to the claims procedure established by the Court. To date, the Receiver has distributed in excess of \$119,000,000, which would be credited dollar-for-dollar against Defendants' restitution obligation.

13. As described above, Section 6c(d)(1) of the Act, 7 U.S.C. § 13a-1(d)(1), permits the court to assess against a person who violates the Act a CMP of not more than the higher of \$130,000 for each violation occurring from October 23, 2004 through October 22, 2008 and not more than the higher of \$140,000 for violations occurring after October 23, 2008, or triple the monetary gain to defendant for each violation of the Act and regulations. 17 C.F.R. § 143.8 and 73 Fed. Reg. 57512 (October 3, 2008).

14. In light of the egregiousness and continuing nature of the fraud in this case that occurred over a period of at least five years, a CMP against both Baker, the controlling person of the LS Common Enterprise, and LSAM, the registered CPO and CTA, is appropriate. It is undisputed that Baker and LSAM violated the Act's core anti-fraud provisions on numerous occasions and concealed their fraud by sending false account statements to their customers. As this Court has found, Baker and LSAM misappropriated at least \$11.3 million of customer funds.

15. There is not a scintilla of evidence in the record that mitigates Baker's and LSAM's fraudulent conduct. To the contrary, Baker and LSAM flouted this Court's orders and concealed LSAM's books and records. Baker and LSAM's refusal to participate in the instant litigation and refusal to obey this Court's orders should be considered an additional aggravating factor.

16. Based on the foregoing, the Commission requests that this Court assess a CMP of \$33.9 million each against Baker and LSAM, which represents triple the monetary benefit to Defendants. *See In the Matter of Slusser*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,701 at 48,318 ("The Commission also has indicated that where a violation involves customer fraud, it will consider in assessing penalties the financial benefit to the respondent.")

Given the egregious and continuing nature of Baker's and LSAM's fraudulent conduct, the maximum CMP permitted pursuant Section 6c(d)(1), which here is \$33.9 million, is appropriate.

17. A proposed Order is attached.

Wherefore, the Commission respectfully requests that the Court enter a default judgment order:

A. finding all Defendants jointly and severally liable for restitution in the amount of \$274,148,513.40, to make whole each and every customer whose funds were received by Defendants and who was harmed by Defendants' wrongful acts; and

B. Requiring LSAM and Baker to each pay a civil monetary penalty of \$33.9 million.

C. Entering such other equitable relief as the Court may deem necessary or appropriate under the circumstances.

Date: October 31, 2011

Respectfully Submitted,
/s/ Diane M. Romaniuk

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CERTIFICATE OF SERVICE

The undersigned, an attorney with the Commodity Futures Trading Commission, certifies that on October 31, 2011, I caused the foregoing,

- *Notice of Motion*
- *Plaintiff's Motion For Renewed Application for Entry Of A Default Judgment Order Resolving All Outstanding Issues, Including Imposition of Restitution And Civil Monetary Penalty.*
- *[Proposed] Final Judgment Order of Restitution and Civil Monetary Penalty*
- *Memorandum In Support of Plaintiff's Renewed Application for Entry of A Default Judgment Order Of Restitution and Civil Monetary Penalty.*

to be electronically filed with the Clerk of the Court using CM/ECF and to be served on the following individuals by Electronic means and/or ECF notification.

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