

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

<b>UNITED STATES COMMODITY</b>	)	
<b>FUTURES TRADING COMMISSION,</b>	)	
<b>Plaintiff,</b>	)	
	)	
<b>v.</b>	)	<b>07 C 3598</b>
	)	
<b>LAKE SHORE ASSET MANAGEMENT</b>	)	
<b>LIMITED, et al.,</b>	)	
<b>Defendants.</b>	)	

**MEMORANDUM AND ORDER**

The court held an evidentiary hearing in connection with the CFTC’s motion for a preliminary injunction based on Lake Shore Limited’s alleged fraud. The parties’ proposed findings of fact and conclusions of law are before the court. For the following reasons, and as set forth more fully below, the CFTC’s motion for a preliminary injunction is granted in part and denied in part.

**I. Findings of Fact**

**A. The Parties**

1. Plaintiff the Commodity Futures Trading Commission (“CFTC”) is an independent federal regulatory agency. (First Amended Complaint at ¶ 11).
  
2. Defendant Lake Shore Asset Management Limited (“Lake Shore Limited”) is a Bermuda corporation that was formed on September 12, 2006. (Amended Decl. of P. Baker, Def. Ex. 5, Tab A). Lake Shore Limited became registered with the CFTC as a CTA and CPO to do business within the United States on January 17, 2007. (Amended Decl. of P. Baker, Def. Ex. 5, at ¶ 3; H. Johnson, Tr. at 143:22-23; Answer at ¶¶ 8, 16). It is a member of the NFA and registered with the CFTC to operate as a commodity pool

operator (“CPO”) and commodity trading advisor (“CTA”). (Plt. Ex. 15, Brodersen ¶ 2; Stipulation, Tr. 370).

**B. Other Relevant Individuals**

3. Laurence Rosenberg is a principal of Lake Shore Limited and a former Chairman of the Chicago Mercantile Exchange. (Amended Decl. of P. Baker, Def. Ex. 5 at ¶ 14). Mr. Rosenberg resides in the United States and his professional reputation is of significant value to Lake Shore Limited. (*Id.* at ¶¶ 5 and 14). He is also a director of Lake Shore Funds I, II, III, and IV, but does not do any trading for the Funds and has no day to day involvement in the Funds or the operation of any of the Lake Shore Group entities.
4. Philip Baker is the Managing Director, Principal and President of Lake Shore Limited (M. Spear, Tr. 20:13-14; Plt. Ex. 4 at 32; Plt. Ex. 5 at 1-3; Def. Ex. 5 at ¶ 1). Mr. Baker is also the co-founder and managing partner of the Lake Shore Group of Companies and Lake Shore Institutional & Dealer Relations. (Plt. Ex. 4 at 32; Plt. Ex. 6 at CFTC Bates 100 06 0024; Ex. 9 at CFTC Bates 299 02 0017; M. Spear, Tr. 34:8-10; Def. Ex. 11, Def. Ex. 5 at ¶ 1). In addition, Mr. Baker is the President and Secretary of Lake Shore Alternative Financial Asset Ltd. (Plt. Ex. 14 at 2; Plt. Ex. 20 at CFTC Bates 105 00 0022 and 0026) and the Lake Shore Alternative Financial Asset Account (Plt. Ex. 20 at CFTC Bates 105 08 0014).
5. Nicholas Eveleigh was the Vice President of Operations and the compliance contact for the Lake Shore Group. (M. Spear, Tr. 31:3-4 and 22-23).
6. For regulatory purposes, an individual may be affiliated with multiple firms. (H. Johnson Tr., 159:11-20; Brodersen Tr. 238:23-25). For regulatory purposes, the actions of an

individual who is affiliated with multiple firms do not necessarily carry over to the other firms. (H. Johnson, Tr. 159:21-23).

**C. The Witnesses**

7. Mary Beth Spear is an investigator with the CFTC's Division of Enforcement. (M. Spear, Tr. 17:19-20). Her position requires her to conduct investigations to ensure compliance with the Commodity Exchange Act ("the Act") and the CFTC's regulations. (*Id.*) She has worked for the CFTC for over 20 years. (M. Spear, Tr. 17:16-18:1). Ms. Spear testified on behalf of the CFTC. Lake Shore Limited also called Ms. Spear as a witness in an effort to lay foundation for many of its exhibits.
8. The National Futures Association ("NFA") is a registered futures association under 7 U.S.C. § 21. It is a not for profit membership corporation that serves as the commodity futures and options industry's self-regulatory organization. The NFA conducts audits and investigations of NFA member firms to ensure compliance with NFA rules and CFTC regulations under 7 U.S.C. § 21. It also has delegated authority from the CFTC to register individuals and entities required to be registered with the CFTC under the Act. 7 U.S.C. § 7(o).
9. Heather Johnson, a Supervisor in NFA's Compliance Department, testified through affidavit (Ptf. Ex. 13) and from the witness stand. She performed a detailed analysis of all Lake Shore accounts held at Sentinel Management Group, Inc. ("Sentinel"), which is a registered futures commission merchant ("FCM").
10. John Brodersen, an Associate Director in the Compliance Department of the NFA, testified through affidavit (Plt. Ex. 15) and from the witness stand.

11. Both the CFTC and Lake Shore Limited called Eric Bloom, Sentinel's President, to testify.

**D. The Lake Shore Group of Companies**

*The Companies*

12. Lake Shore Limited is one of the companies associated with the Lake Shore Group of Companies ("Lake Shore Group"). (Amended Decl. of P. Baker, Def. Ex. 5 at ¶ 3).  
More specifically, Lake Shore Limited's legal name is "Lake Shore Group of Companies Inc., Ltd." (Plt. Ex. 5 at 223 07 0234). Lake Shore Group and associated companies have been operating businesses since 1994. (Amended Decl. of P. Baker, Def. Ex. 5 at ¶ 2).  
Lake Shore Group offers investment funds and managed accounts which trade in commodity futures contracts. (*Id.*).
13. With the exception of one investment fund established in the United States in April 2007 (Lake Shore IV – U.S.), Lake Shore Group has not marketed to or accepted any residents of the United States, its territories or possessions in any of Lake Shore Group's trading programs, and all of its investment funds are located outside of the United States. (*Id.*)
14. Lake Shore Asset Management Inc. ("Lake Shore Inc.") is also affiliated with the Lake Shore Group of Companies and is registered separately with the NFA. (J. Brodersen, Tr. 258:6-25 and 261:4-7).
15. Lake Shore Inc. is the firm name for Lake Shore Alternative Investment, which is 100% owned by Senior Management of Lake Shore Asset Management. (Plt. Ex. 8 at CFTC Bates 299 02 0014).

16. Lake Shore Limited is the reorganized version of Lake Shore Inc. (J. Brodersen, Tr. 258:9-11).
17. Lake Shore Alternative Financial Asset Ltd. is another company affiliated with the Lake Shore Group. Mr. Baker (in his capacity as President and Secretary of Lake Shore Alternative Financial Asset Ltd.) and John Kurgan (the Chief Executive Officer of Lake Shore Alternative Financial Asset Ltd.) were authorized to execute money transfers at Sentinel on behalf of Lake Shore Alternative Financial Asset Ltd. (Plt. Ex. 14, p. 2; Plt. Ex. 20 at CFTC Bates 105 08 0011).
18. Lake Shore Alternative Financial Asset Account is yet another company associated with the Lake Shore Group. Mr. Baker is its President and Secretary, and Mr. Kurgan is the Chief Executive Officer. (Plt. Ex. 20 at CFTC Bates 105 08 0014).

***Interrelationship Between Lake Shore Limited, the Lake Shore Group, and Mr. Baker***

19. Lake Shore Group's promotional materials refer to "Lake Shore," the Lake Shore Group, Lake Shore Inc., and Lake Shore Limited interchangeably. The Lake Shore Group PowerPoint presentation or "Pitch" which was produced to the CFTC by Mr. Eveleigh contains a page entitled "History of the Portfolio Management Company." On that page, Lake Shore Group states that it has offices in Chicago, London, Geneva, Bermuda, and Hong Kong, and that Lake Shore Limited is a reorganization of Lake Shore Asset Management Inc. (Plt. Ex. 4 at 4) ("Lake Shore Asset Management Inc. (reorganization in 2006 to Lake Shore Asset Management Limited, Bermuda) founded in Chicago, Illinois in 1993"). It also refers repeatedly to "Lake Shore." (Plt. Ex. 4, *passim*).

20. In addition, the Pitch represents that the Lake Shore Group of Companies' product range includes funds operated and managed by "Lake Shore Asset Management" and third-party structured products "[m]anaged by Lake Shore Asset Management." (*Id.* at 3). It also explicitly states that Lake Shore Limited is the trading manager for Lake Shore's funds as well as a CTA and CPO. (*Id.* at 10).
21. A document on Lake Shore Group's letterhead entitled "Qualitative Firm Evaluation & Due Diligence Lake Shore Asset Management Limited" states that Lake Shore Limited's web address is [www.lakeshorefunds.com](http://www.lakeshorefunds.com). (Plt. Ex. 9; Plt. Ex. 15, J. Brodersen Aff. at ¶ 4).
22. Lake Shore Inc. and Lake Shore Limited were both located at 875 N. Michigan Ave., Suite 1562, Chicago, Illinois. (Plt. Ex. 2; Plt. Ex. 8). Lake Shore Group letterhead states that it has offices in Chicago without providing any other address. (*See e.g.*, Plt. Ex. 6 at CFTC Bates 100 06 0015).
23. Lake Shore Limited/Lake Shore Group's management personnel are located in Chicago. (Plt. Ex. 4 at 23). They also have administrative/IT/operations staff, and execution staff in Chicago. (*Id.*).
24. Lake Shore Limited and Lake Shore Inc.'s printed materials relating to the Lake Shore Alternative Financial Asset Funds are on Lake Shore Group stationery and contain the Lake Shore Group's logo. (Plt. Exs. 4, 6, 8, 9).
25. Information and performance results for the funds managed and advised by Lake Shore Limited are available on the Lake Shore Group's website. (Plt. Ex. 15, J. Brodersen Aff. at ¶ 6).

26. Mr. Baker is the Managing Director, Principal and President of Lake Shore Limited (M. Spear, Tr. 20:13-14; Plt. Ex. 4 at 32; Plt. Ex. 5 at CFTC Bates 223 07 0236) and the co-founder and managing partner of the Lake Shore Group of Companies and Lake Shore Institutional & Dealer Relations. (Plt. Ex. 4 at 32; Plt. Ex. 6 at CFTC Bates 100 06 0024; Plt. Ex. 9 at CFTC Bates 299 02 0017; M. Spear, Tr. 34:7-10; Def. Ex. 11, Second Declaration of Philip Baker, at ¶1).
27. Lake Shore Limited's Due Diligence, which is dated June 2007, lists Mr. Baker as Lake Shore Limited's contact person. (Plt. Ex. 5 at CFTC Bates 223 07 0233).
28. Mr. Baker holds the primary responsibility of managing Lake Shore Limited and the Lake Shore Group of Companies' overall international business development, operations, sales and marketing. (Plt. Ex. 4 at 32).
29. Lake Shore's Alternative Investment Due Diligence Questionnaire dated September 2005 that was provided to the Bank of Montreal-Ireland provides that Philip J. Baker is the Managing Partner of Lake Shore Asset Management Inc. (Plt. Ex. 8 at CFTC Bates 299 02 0003). It also lists Mr. Baker as the person who prepared and reviewed the questionnaire on behalf of Lake Shore Inc. (J. Brodersen, Tr. 274:4-6; Plt. Ex. 8 at CFTC 299 02 0003).
30. Lake Shore Limited solicited customers through dealers affiliated with the Lake Shore Group. (M. Spear, Tr. 50:19-24).
31. The Pitch that was produced to the CFTC by Mr. Eveleigh describes Lake Shore Limited as part of the Lake Shore Group. (Plt. Ex. 4 at 2). Mr. Eveleigh also produced

organizational charts and various offering memoranda for the Lake Shore Alternative Financial Asset Funds. (Plt. Ex. 4 at 2; M. Spear, Tr. 24:11-15 and 25:21-24).

32. Mr. Rosenberg told NFA staff that the Lake Shore Group consists of Lake Shore Limited. (Plt. Ex. 15, J. Brodersen Aff. at ¶ 8). This is consistent with the organizational chart contained in the Pitch.
33. Lake Shore Group/Lake Shore Limited operate four foreign investment funds, Lake Shore Alternative Financial Asset I, Lake Shore Alternative Financial Asset II, Lake Shore Alternative Financial Asset III, and Lake Shore Alternative Financial Asset IV. (Amended Decl. of P. Baker, Def. Ex. 5 at ¶ 6).
34. The Pitch also shows that Lake Shore Limited provides or manages all of the Lake Shore Group's products. (Plt. Ex. 4 at 10 and 4). Specifically, Lake Shore Limited provides 7 products: Lake Shore Alternative Asset Account I, Lake Shore Alternative Asset Account II, Lake Shore Alternative Financial Asset Funds I, II, III and IV and Lake Shore Alternative Financial Asset Yen Fund. (Plt. Ex. 4 at 3).
35. Mr. Brodersen reviewed a press release dated January 29, 2007. (Plt. Ex. 15, J. Brodersen Aff. at ¶ 5 and exhibit A to affidavit). The press release was from Lake Shore Limited, was on Lake Shore Group letterhead, and referred to [www.lakeshorefunds.com](http://www.lakeshorefunds.com). *Id.* Mr. Brodersen testified that the press release does not distinguish between Lake Shore Group and Lake Shore Limited. (J. Brodersen, Tr. 166:4-10). It announced the launch of Fund IV, and stated "in its 13 year history, Lake Shore's flagship program has generated a 28.27 percent return." (J. Brodersen, Tr. 166:4-6; Plt. Ex. 15, J. Brodersen Aff. at ¶ 5 and exhibit A to affidavit ). It also noted that Lake Shore "is a member of the

NFA and is regulated by the CFTC.” (J. Brodersen, Tr. 166: 1-3; Plt. Ex. 15, J. Brodersen Aff. at ¶ 5 and exhibit A to affidavit).

***The Lake Shore Funds***

36. The court prepared a summary chart, which is attached hereto as Exhibit 1. This chart is drawn directly from the exhibits and depicts the organization of the funds at the FCM level. Specifically, it is a combination of and drawn from Plt. Ex. 15 (Mr. Brodersen’s declaration and the accompanying exhibits) and Plt. Ex 4 at p.3 (the Pitch). In the interests of simplicity, however, the court omitted the details for the Yen funds.
37. Lake Shore represents that it has a total of \$1.05B under management. Lake Shore Fund I and Lake Shore Fund II consist of direct managed accounts (listed as segregated managed accounts or separately managed accounts (“SMAs”) on Lake Shore’s materials) and trading accounts, while Lake Shore Fund III and Lake Shore Fund IV consist of trading accounts only. (Plt. Ex. 15, J. Brodersen Aff., exhibit B attached to affidavit).
38. Lake Shore Alternative Financial Asset Fund I, Lake Shore Alternative Financial Asset Fund II, and Lake Shore Alternative Financial Asset Fund III are organized in the Turks and Caicos Islands. (Amended Decl. of P. Baker, Def. Ex. 5 at ¶ 6).
39. Lake Shore Alternative Financial Asset Fund IV is organized in the British Virgin Islands. (Amended Decl. of P. Baker, Def. Ex. 5 at ¶ 6).
40. Clients invest in a specific investment fund (*e.g.*, Lake Shore Alternative Financial Asset Funds I, II, III, or IV). Their money is deposited in accounts at custodian/sub-custodian FCMs used for trading activities which are operated by that fund. According to the fact sheets for all of the Lake Shore Alternative Financial Asset Funds, Lake Shore funds

were trading as of January of 1994 (Lake Shore Alternative Financial Asset Fund I and Lake Shore Alternative Financial Asset Fund Yen Fund, which both had the new 5% risk model introduced in 2003), January of 2005 (Lake Shore Alternative Financial Asset Fund II and Lake Shore Alternative Financial Asset Fund Yen Fund Class II), May of 2006 (Lake Shore Alternative Financial Asset Fund III and Lake Shore Alternative Financial Asset Fund Yen Fund Class III), February of 2007 (Lake Shore Alternative Financial Asset Fund IV), and May of 2006 (Lake Shore Alternative Financial Asset Fund IV Class E). (Plt. Ex. 19).

41. Lake Shore Alternative Financial Asset Fund IV U.S., LLC was formed on April 17, 2007, as an Illinois limited liability company. (Amended Decl. of P. Baker, Def. Ex. 5, Tab B.) Fund IV–U.S. has a single United States investor (Mr. Stoltz) who invested on May 8, 2007. (Amended Decl. of P. Baker, Def. Ex. 5 at ¶ 4).
42. Fund IV–U.S. invested in Lake Shore Fund IV (which consists of Lake Shore Alternative Financial Asset Fund IV). (M. Spear, Tr. 114:9-11; J. Brodersen, Tr. 248:3-4). The money invested by Mr. Stoltz was deposited at Sentinel and transferred from Fund IV–U.S. to the Lake Shore Alternative Financial Asset Fund IV account at Sentinel in Sentinel’s capacity as an FCM. (J. Brodersen Tr. 248:12-15).
43. Lake Shore Alternative Financial Asset Funds I, II, III, and IV are separate legal entities with separate boards of directors. (Amended Decl. of P. Baker, Def. Ex. 5 at ¶ 6).
44. Man Financial London (“Man”), Lehman Brothers London (“Lehman”), and Fimat London (“Fimat”) maintain the trading accounts for the Lake Shore Alternative Financial Asset Funds. (M. Spear, Tr. at 77:7-19).

45. There is no evidence that anyone ever complained about the Lake Shore accounts to Fimat, Man, or Lehman Brothers between 2002 and up to the time of the asset freeze imposed by this court (which has since been vacated) and the continuing asset freeze imposed by the NFA pursuant to a Member Responsibility Action. (J. Brodersen, Tr. 251:25-252:23).
46. Sentinel is the cash manager and the subcustodian for the Lake Shore Alternative Financial Asset Funds. (M. Spear, Tr. 70:14-16; H. Johnson, Tr. 133:8-10; Plaintiff. Ex. 4 at 0012). No one has ever complained to Sentinel regarding the Lake Shore accounts. (E. Bloom, Tr. 358:2-6). The Bank of New York is the custodian for the Lake Shore Alternative Financial Asset Funds. Thus, the Bank of New York, as custodian, and Sentinel, as subcustodian, maintain custody of the funds. (M. Spear, Tr. 77:2-6).
47. A fund flow chart for Fund IV depicts Lake Shore Limited as the trading manager for Fund IV. (Plt. 4 at 10). Lake Shore Alternative Financial Asset's fact sheets for Lake Shore I, Lake Shore II, Lake Shore III, and Lake Shore IV dated "05/07" state that the respective funds are "managed by Lake Shore Asset Management Limited which is a Commodity Trading Advisor (CTA) and Commodity Pool Operator (CPO) registered with the CFTC in the U.S. and is a member of the National Futures Association." (Plt. Ex. 19; *see also* Plt. Ex. 4 at 5). The fact sheets are on Lake Shore Group of Companies letterhead and state that they were issued by "Lake Shore Group of Companies Inc., Limited." (*Id.*)
48. The Confidential Explanatory Memorandum for Lake Shore Alternative Financial Asset Fund IV Ltd. states that Lake Shore Limited is the investment manager and investment

advisor, “has sole authority and responsibility for the investment of the Fund’s assets,” and researches, identifies, and monitors possible investments of the Fund.” (Plt. Ex. 6 at CFTC Bates 100 06 0023).

49. Lake Shore Limited’s Due Diligence dated September of 2006 states that Lake Shore Limited is the Investment Advisor for the Lake Shore Group of Companies. (Plt. Ex. 9 at CFTC Bates 299 02 0016). Similarly, the Confidential Explanatory Memorandum for Fund IV dated February of 2007 state that Lake Shore Limited is the Investment Manager and Investment Advisor. (Plt. Ex. 6 at CFTC Bates 100 06 0021). In addition, as noted above, the Pitch explicitly states that Lake Shore Limited is the trading manager for Lake Shore’s funds as well as a CTA and CPO. (Plt. Ex. 4 at 10).
50. Mr. Baker testified via declaration that Lake Shore Group intended Lake Shore Limited to act as the Lake Shore Alternative Financial Asset Funds’ investment advisor, but this plan was not carried out as a result of this action and a parallel action by the National Futures Association. (Amended Decl. of P. Baker, Def. Ex. 5 at ¶ 9). This action and the NFA action were filed in June of 2007. Mr. Baker’s statement that Lake Shore Limited never acted as the funds’ CTA due to actions occurring in late June of 2007 is at odds with numerous Lake Shore documents which predate the institution of this action and the separate NFA action. Moreover, as outlined above, numerous Lake Shore documents clearly state that Lake Shore Limited is the CTA for the Lake Shore Alternative Financial Asset Funds. The court declines to credit Mr. Baker’s unsupported assertion because it is inconsistent with multiple documents which predate this action and is not credible given the lack of any supporting detail or explanation.

*The Sentinel Accounts*

51. As noted above, funds own accounts that are deposited with them and the monies in the accounts are deposited at FCMs. Thus, Lake Shore Limited is not the named owner of the accounts at the FCMs. (J. Brodersen, Tr. 249:2-5, 250:3-7; Def. Exs. 1, 2, 3 & 4).
52. Lake Shore Limited maintains 35 accounts at Sentinel under the name Lake Shore Alternative Financial Asset Ltd. (Plt. Ex. 10; Plt. Ex. 13 at ¶¶ 8, 12; M. Spear, Tr. 57:1-3; H. Johnson, Tr. 134:2-15).
53. There is no direct trading at the fund level as the fund is a client of the account. (Plt. Ex. 5 at CFTC Bates 223 07 0238). In other words, the money in the trading accounts and is traded from those accounts, and the respective funds own the trading accounts. This means that a trading advisor or pool operator cannot hold accounts in their own names and Lake Shore Limited itself, as an entity, has no authority to withdraw assets held with the custodians of the Lake Shore Alternative Financial Asset Funds. (M. Spear, Tr. 71:20-22; J. Brodersen, Tr. 249:6-8, 250:8-11).
54. Lake Shore Limited does not receive customer funds, but instead these funds go through the Bank of New York to Sentinel. (M. Spear, Tr. 71:23 – 72:18).
55. Principals and employees of Lake Shore Limited were authorized to transfer funds in all of Lake Shore's accounts at Sentinel from at least June 28, 2001. (Plt. Ex. 14 at 1, 2; E. Bloom, Tr. 292:7-17). Mr. Baker and Mr. Eveleigh, among others, are authorized to transfer funds from the 35 Sentinel accounts. (Plt. Exs. 14, 20; H. Johnson, Tr. 153:10-154:11).

56. The Transfer Authorization form prepared by Mr. Eveleigh and maintained by Sentinel for the Lake Shore Limited accounts does not list specific account names or numbers but instead states, "Lake Shore (all accounts)." (Plt. Ex. 14 at 1; Plt. Ex. 20). Each of the accounts at Sentinel are thus under the control of the same people.
57. The initial Lake Shore account at Sentinel was opened in July 2001 and was afterward entitled Lake Shore Alternative Financial Asset Limited. (E. Bloom, Tr. 287:10-290:15; Plt. Ex. 20). Lake Shore opened several additional accounts at Sentinel but because all of the accounts had the same owner, new account opening documents were not required. (E. Bloom, Tr. 290:21-24; Plt. Ex. 20).
58. The Lake Shore Alt. Financial Asset Fund IV US, LLC–Income account at Sentinel, was opened on April 9, 2007 and funded on May 3, 2007 with \$1,000,000. (Plt. Ex. 13 at ¶¶ 12, 13; H. Johnson, Tr. 134:7-21). The \$1,000,000 was wire transferred from Mark Stoltz, a U.S. citizen, for the benefit of Lake Shore. (Plt. Ex. 13 at ¶ 19; H. Johnson, Tr. 136:9-13). On May 14, 2007, \$1,000,000 was transferred out of Lake Shore's U.S. Income account into another Lake Shore account, Lake Shore Alternative Fund IV Ltd.–Trading. (Plt. Ex. 13 at ¶ 19; H. Johnson, Tr. 136:13-21).
59. Ms. Johnson noted that seven transfers totaling \$2,107,532.96 were made between Lake Shore Limited's various Sentinel accounts in June of 2006. (Plt. Ex. 13 at ¶¶ 20-21). Based on her review of the documents, Ms. Johnson concluded that monies were being transferred from Lake Shore Alternative Financial Asset I, II, and III to IV. She opined that this suggested that Lake Shore did not treat Lake Shore Alternative Fund IV-Trading as independent from the other accounts. (Plt. Ex. 13 at ¶ 21; H. Johnson, Tr. 139:6-10).

It is possible that the transfers were legitimate, but Lake Shore Limited offered no evidence explaining why the transfers were made.

60. In response to questions from Lake Shore Limited's counsel, Mr. Brodersen testified that a transfer of assets between two funds could be consistent with a "fund of funds" investment, an investor's decision to change its investment to a different fund, or a feeder fund concept. (J. Brodersen, Tr. 244:18-20; 244:21-245:3; 247:2-11). No evidence, documentary or otherwise, supports a finding that the transfers were actually made for any of these reasons. There is no evidence that indicates why the funds were transferred.
61. The funds of the one known U.S. investor were initially deposited into an account at Sentinel in the name of Lake Shore Alternative Financial Asset Fund IV US LLC—Income. Eleven days later, these funds were transferred to the Lake Shore Alternative Fund IV Ltd. Account. (Plt. Ex. 15, J. Brodersen Aff. at ¶ 36). There is no account at any of the trading FCMs in the name of Lake Shore Alternative Fund IV—US. (Plt. Ex. 15, J. Brodersen Aff. at ¶¶ 26, 30, 31).
62. When pool participants add funds to Lake Shore Alternative Financial Asset Fund IV, they notify Lake Shore Limited. (Plt. Ex. 6 at CFTC Bates 100 86 0042). This indicates that Lake Shore Limited is soliciting and accepting funds for the purpose of trading through Fund IV. (J. Brodersen, Tr. 243:7-13).

*The Trading Accounts*

63. As noted above, Lake Shore Limited's trading accounts are at Man, Lehman, and Fimat, and are controlled by Mr. Baker and Mr. Eveleigh. (Def. Ex. 1-D at 10; Def. Ex 1-A at 3; Def. Ex. 2-D at 9-10).
64. One document states that Man is the prime broker for Lake Shore Alternative Investment and indicates that there are seven other brokers, but does not provide a list of these brokers. (Plt. Ex. 8 at CFTC Bates 299 02 0002). If any of these brokers was not an NFA member, Mr. Brodersen would not know about their existence and would not be able to secure their records. (J. Brodersen, Tr. 276:13-19).
65. According to Mr. Baker and Mr. Rosenberg, the Lake Shore Alternative Financial Asset Funds are traded through only three FCMs: Fimat, Man, and Lehman. (J. Brodersen, Tr. 190:21-191:7; 261:8-13).

***Risk Management Overlay***

66. In 2003, Lake Shore Group instituted a risk management overlay consisting of a systemwide 5% monthly drawdown limit with no discretion, where the models will reduce margin to equity traded if losses accumulate. (Plt. Ex. 4 at CFTC Bates 223 04 0021 and 0022; Plt. Ex. 5 at CFTC Bates 223 07 0239 and 0240; Plt. Ex. 9 at CFTC Bates 299 02 0021). This completely automated system was put into place after a 48.56% monthly drawdown in July of 2002. (Plt. Ex. 5 at CFTC Bates 223 07 0241).
67. Lake Shore Group has disclosed that investing in futures derivatives involves significant risk factors and can quickly lead to large losses as well as gains. (Plt. Ex. 6 at CFTC Bates 100 06 0021-22). Nevertheless, it has also represented that since implementation of the risk overlay, its worst daily drawdown has been 5%, and its monthly drawdown is

targeted at no more than 5%. (Plt. Ex. 8 at CFTC Bates 299 02 0006). In addition, Lake Shore Limited's due diligence represents that it will have a maximum monthly drawdown of 5%, and that this strategy has been successful for more than 39 months. (Plt. Ex. 9 CFTC Bates 299 02 0023). This overlay is consistent with the monthly returns listed in the fact sheets for Lake Shore Alternative Financial Funds I, II, III, and IV. (Plt. Ex. 19).

68. Lake Shore Alternative Financial Asset Fund II showed monthly trading losses of greater than 5%/month for four of nine months between October 2006 and June of 2007. (Plt. Ex. 18 at 11-12, reflecting losses of -5.45% for 10/06, -17.03% for 11/06, -9.71% for 3/07, and -20.20% for 5/07, calculated using Mr. Brodersen's formula of dividing the net performance by beginning net asset value for the relevant period).<sup>1</sup> Similarly, Lake Shore Alternative Financial Asset Fund I shows trading losses for March through May of 2007 that are substantially higher than 5%. (*Id.*, reflecting losses of -39.08% for 3/07, -21.19% for 4/07, and -70.87% for 5/07).

**E. Lake Shore Limited and Lake Shore Inc.'s Status as CFTC Registrants and NFA Members**

69. On June 21, 2007, Lake Shore Limited was served with a request by the Commission pursuant to Section 4n of the Act. The request sought immediate production of Lake Shore Limited's books and records, including but not limited to, a list with the name and complete address of each client, subscriber, or participant, and samples or copies of all reports, letters, circulars, memoranda, publications, writings, or other literature or advice

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<sup>1</sup> This is the calculation method used by Mr. Brodersen when he computed the performance of the trading accounts for Lake Shore Alternative Financial Asset Fund IV. (Plt. Ex. 18 at p.13).

distributed to clients, including documentation disclosing all futures accounts. (Plt. Ex. 1,2; M. Spear, Tr. 20:21-23:8).

70. Lake Shore Limited has been registered with the CFTC as a CPO and as a CTA since January 17, 2007 and has been an NFA member since that time. (Plt. Ex. 15, J. Brodersen Aff. at ¶ 2; Stipulation, Tr. 369).
71. Prior to January 2007, Lake Shore held itself out as a CFTC registrant under the registration of Lake Shore Inc. Lake Shore Inc. was registered with the CFTC and an NFA member until February 2007, when it withdrew its registration. Lake Shore Inc. retained its registration status at the request of Mr. Baker until Lake Shore Limited was registered with the NFA. (Plt. Ex. 12, T. Church Decl. at ¶¶ 1,8).
72. Lake Shore Alternative Investment also held itself out as being subject to U.S. regulation. (Plt. Ex. 8 at 299 02 002).
73. Lake Shore Limited's promotional materials state that it is doing business as a CFTC registrant and that it is a NFA member. (Plt. Ex. 19 at 1). In addition, the account opening documents at Man for Lake Shore Alternative Financial Asset Fund IV, Ltd. dated March 26, 2007, state that "the company is authorised by" the NFA and provides an NFA reference number 0372911<sup>2</sup>, which is Lake Shore Limited's NFA identification number. (Def. Ex. 1-D at 1-2). In the Pitch, the Lake Shore Group refers to Lake Shore Limited's NFA identification number. (Plt. Ex. 4 at 5). Thus, Lake Shore Limited

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<sup>2</sup> The court notes that page 2 of Def.'s Ex. 1-D contains a different reference number, 0392711. This appears to be a typographical error.

opened Lake Shore Alternative Financial Asset Fund IV acting in its capacity as a CFTC registrant.

74. Exhibit 19 consists of eight Fact Sheets dated May 31, 2007 for eight Lake Shore Alternative Financial Asset Funds and one Fact sheet dated December 31, 2006 for Lake Shore Alternative Financial Asset Fund IV Limited. The Fact Sheets for Lake Shore Alternative Financial Asset Funds I, II, III, and IV (Dec. 2006), Yen Fund Ltd, Yen Fund Limited II and Yen Fund Limited III state that the respective funds are managed by Lake Shore Limited, a registered CPO and CTA. (Plt. Ex. 19; M. Spear, Tr. 43). According to the fact sheets, Lake Shore Limited acted as a CPO and a CTA in connection with each of these funds. (Plt. Ex. 19).
75. In the due diligence documents for Lake Shore Limited, it is described as “registered with the CFTC in 1996 and with the National Futures Association (NFA),” (Plt. Ex. 5 at CFTC Bates 223 07 0234), as well as “a registered commodity trading advisor...,” (Plt. Ex. 5 at CFTC Bates 223 07 0235 and 0238).
76. Lake Shore Limited’s Alternative Investment Due Diligence Questionnaire advises future clients that “[r]elying on statements from Lake Shore and its regulatory history provides the comfort available,” as opposed to receiving redacted information about performance from past or existing clients. (Plt. Ex. 8 at CFTC Bates 299 02 0004).
77. The Pitch contains numerous representations that Lake Shore Inc. – now reorganized into Lake Shore Limited – is a CFTC registrant and NFA member. Specifically, it represents that: (a) Lake Shore Limited, as the reorganized version of Lake Shore Inc., “in 2000 applied to regulators to begin operations in other parts of the world” (Plt. Ex. 4 at 4); (b)

“Lake Shore is a registered money manager which specialises in Exchange Traded Financial Derivatives” (Plt. Ex. 4 at 4); (c) “Lake Shore is a CTA . . . , CPO . . . , Member of the NFA . . . and Registered with the CFTC. . . .” (Plt. Ex. 4 at 5, 10, 18, 37); (d) “All Futures Professionals register with the NFA” (Plt. Ex. 4 at 6); and (e) “NFA provides Audits, Investigations, Review of Promotional Materials and Disclosure Documents, Trade Practice and Market Surveillance, Arbitration and Recourse” (Plt. Ex. 4 at 6). The document’s references to Lake Shore Limited and “Lake Shore” refer to the same entity: Lake Shore Limited. (Plt. Ex. 4).

78. Lake Shore’s website represented that it was founded as Lake Shore Inc. in 1993 and reorganized in 2006 as Lake Shore Asset Management, Ltd. of Bermuda. (Plt. Ex. 15, J. Brodersen Aff. at ¶ 7). The website represented that Lake Shore was regulated by the CFTC and the NFA. (*Id.*)
79. Sebastian Sainsbury, one of the Lake Shore salesmen, told Mr. Brodersen that one of the key points in Lake Shore’s sales presentations was that they were registered in the U.S. with the CFTC and were also NFA members. (J. Brodersen, Tr. 211:14-17). This is supported by the fact that the Pitch stresses that Lake Shore is a CFTC registrant and NFA member.

**F. Lake Shore Limited and Lake Shore Inc.’s Status as Active CTAs and/or CPOs**

80. According to the Confidential Explanatory Memorandum for Lake Shore Fund IV (“Confidential Memorandum”), Fund IV “seeks to maximize returns whilst preserving capital by investing in three assets, Lake Shore Alternative Financial Asset Fund Ltd.

(LSAFA I), Lake Shore Financial Asset Fund II Ltd. (LSAFA II), and Lake Shore Alternative Financial Asset Fund III Ltd. (LSAFA III).” (Plt. Ex. 6 at CFTC Bates 100 86 0021, 0023; M. Spear, Tr. 35:18-21 and 42:7-10). The Fund IV Fact Sheet says the same thing. (Plt. Ex. 6 at CFTC Bates 100 86 0045).

81. The Confidential Memorandum also states that Fund IV “utilized the proprietary trading program developed and operated by Lake Shore Asset Management Limited...” (Plt. Ex. 6 at CFTC Bates 100 86 0021).
82. The Confidential Memorandum further states that “[t]he investment Manager of the Fund is Lake Shore Limited and the Investment Advisor is Lake Shore Limited, a corporation incorporated in Hamilton, Bermuda and a registered CTA...” (Plt. Ex. 6 at CFTC Bates 100 86 0021, 0023, 0024).
83. Mr. Brodersen believed that Lake Shore’s press release of January 2007 on Lake Shore Group of Companies letterhead announcing that Lake Shore Limited is launching Lake Shore Alternative Financial Asset Fund IV meant that Lake Shore Limited was the pool operator for that fund. (J. Brodersen, Tr. 240:1-19).
84. Lake Shore Inc. acted as the CTA for the Lake Shore Alternative Financial Asset Funds before Lake Shore Limited was formed, as shown by the Pitch, which states that Lake Shore Inc. was the registered money manager for these funds, used trading systems “refined and formalized over the years,” (Plt. Ex. 4 at 4, 11-16), and a new risk management program instituted in 2003 (*Id.* at 19-20), which caused it to have a trading system that compared favorably with other CTAs (*Id.* at 22).

85. In addition, Lake Shore Limited's due diligence states that Lake Shore Asset Management "began trading Exchange Traded Derivatives on behalf of clients on January 1, 1994" and uses a proprietary trading methodology. (Plt. Ex. 5 at CFTC Bates 223 07 0235, 0238-0240; Plt. Ex. 9 at CFTC Bates 299 01 0020).
86. Lake Shore Inc.'s due diligence questionnaire relates history for Lake Shore Inc. going back five 5 years to 2002, and states that Lake Shore Inc. managed accounts and executed trades and was a registered CTA and CPO. (Plt. Ex. 8 at CFTC Bates 299 02 0012-0013, 299 02 0004 and 299 02 0006-0007).
87. Lake Shore Inc.'s senior trading staff manages trading for Lake Shore Alternative Investment "on an ongoing basis" and "[a]ll accounts are traded under the Lake Shore Asset Management Inc. proprietary system." (Plt. Ex. 8 at CFTC Bates 299 62 0005, 0008).
88. According to Thomas Church, who was a principal for Lake Shore Inc., he formed Lake Shore Inc. in 1996 to facilitate the sale of a trading system. In 2000 or 2001, Mr. Baker told Mr. Church that he wanted to use Lake Shore Inc. to solicit firms and securities brokers to interest them in getting clients to invest a portion of their portfolios in commodity futures. Mr. Church was concerned that Mr. Baker's concept was not set up in compliance with U.S. law. (Plt. Ex. 12, T. Church Decl. at ¶¶ 1, 4, 6, 7).
89. Until the NFA recently showed him Lake Shore documents, Mr. Church was unaware that the Lake Shore Group was using Lake Shore Inc.'s name in its promotional or disclosure materials. Mr. Church also denied that Lake Shore Inc. was involved in

creating or designing a trading system to be used by the Lake Shore Group. Mr. Church sold the right to use the name Lake Shore Inc. to Mr. Baker in 2006. (*Id.*).

**G. Futures Trading in the United States by Lake Shore Limited**

90. Lake Shore represents in the Pitch that it “only trades regulated exchange traded derivatives.” (Plt. Ex. 4 at 18; J. Brodersen, Tr. 215:6-7).
91. The account statements from Fimat, Lehman and Man show that the Lake Shore Alternative Financial Asset Funds were trading commodity futures contracts on U.S. exchanges. (J. Brodersen, Tr. 263:23-264:3). A substantial amount of losses at Man, Fimat and Lehman occurred as the result of futures trading on U.S. futures exchanges. (Plt. Ex. 15, J. Brodersen Aff. at ¶ 40).
92. Lake Shore told its pool participants that the pools would trade commodity futures contracts on U.S. exchanges. (Plt. Ex. 7; M. Spear, Tr. 44:17-25; Plt. Ex. 19).
93. Each of the fact sheets for the Lake Shore Alternative Financial Asset states that they will trade commodity futures contracts that are traded on U.S. Exchanges. For instance: IMM currencies are traded at the Chicago Mercantile Exchange, U.S. Treasuries are traded at the Chicago Board of Trade and WII crude oil is traded at the New York Mercantile Exchange. (Plt. Ex. 7; J. Brodersen, Tr. 264:2-3; M. Spear, Tr. 44:10-25).

**G. Interest on Sentinel Accounts – Payroll, Expenses, and Real Estate in Greece**

94. Lake Shore uses Anglo International Associates Limited (“Anglo”) for its payroll. (Plt. Ex. 23, E. Bloom, Tr. 294:7-9; M. Spear, Tr. 310:25-311:2). Mr. Rosenberg indicated that his compensation came from Anglo. (M. Spear, Tr. 311:11-13). Sentinel records show that between 2006 and 2007, approximately \$976,207 was wired out from Lake

Shore Accounts at Sentinel to Anglo. (Plt. Ex. 28). In June of 2007, Mr. Eveleigh sent Sentinel an email requesting that \$445,683 be wired to Anglo accounts. (Plt. Ex. 23; E. Bloom, Tr. 294:7-24).

95. The Confidential Memorandum states that “[t]he promoters of the Fund will bear all expenses incurred in connection with its organization and its ongoing operation.” (Plt. Ex. 6 at CFTC Bates 100 86 0021). It also states that Lake Shore Limited will pay its employee’s salaries. (Plt. Ex. 6 at CFTC Bates 100 86 0025).
96. The offering memorandum for Fund IV disclosed that interest would not be paid to the investors on funds held with the custodian. (Plaintiff. Ex. 6 at CFTC Bates 100 86 0025; J. Brodersen, Tr. 330:17-19). However, Lake Shore Limited did not disclose that pool funds were used to pay its employees’ salaries or payroll. (J. Brodersen, Tr. 220:18-23). It also did not disclose that pool funds were being used to pay overhead or the expenses of the pool operator. (*Id.* at 220:13-16).
97. Mr. Brodersen testified that failure to disclose that a pool is paying interest earned on customer funds to a third party should be disclosed due to a conflict of interest. The conflict of interest in this case arose from the fact that the pool operator earns interest on accounts with Sentinel. If it is receiving the interest, it provides an incentive for the operator to maximize the funds at Sentinel to maximize the amount of interest. (*Id.* at 219:19-220:17).<sup>3</sup>

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<sup>3</sup> Specifically, Mr. Brodersen testified “[i]f the pool operator is going to earn all the interest on the accounts that are held at Sentinel, there’s an incentive for that pool operator to keep the maximum amount of funds at Sentinel so that they can earn that interest. It kind of runs contrary to the whole, I guess, concept of a commodity fund where your first goal or the pool operator’s or manager’s goal should be to trade in the markets and make money for the clients.”

98. Mr. Brodersen also testified that if he learned during an audit that a pool operator was using a substantial amount of customer funds to pay for undisclosed expenses, the NFA would take emergency action against that pool operator. (*Id.* at 220:24-221:14).
99. Lake Shore Limited's citation to documents stating that investors were told they would not receive interest from the Sentinel accounts is thus irrelevant because Lake Shore Limited was obligated to disclose a disposition of the interest that created a conflict of interest with the investors, such as the payment of payroll and expenses.
100. As noted above, Lake Shore has 35 accounts at Sentinel. Each account consists of three separate accounts called operating, trading and income. Each account earns interest that accrues daily. At the end of each month, Lake Shore directed Sentinel to move the income from every Lake Shore Fund trading and operating account into the corresponding income account. (E. Bloom, Tr. 285:18-286:1-6 and 354).
101. Usually, a few days into each new month, Lake Shore would direct Sentinel to wire the money out of the income accounts to a company called Hanford Investments ("Hanford"). (E. Bloom, Tr. 286:16-23 and 355:11-15; J. Brodersen, Tr. 218:10-17). Hanford Investments is an introducing broker operated by Baker. (J. Brodersen, Tr. 218:13; M. Spear, Tr. 308:3-7).
102. Sentinel records show that between November 2002 and June 2007, \$9,936,505.74 was wired out from Lake Shore accounts at Sentinel to Hanford for the benefit of Philip

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He then concluded that the "conflict should be disclosed, and just the mere fact that that [sic] interest is going to a third party should be disclosed." Similarly, he stated that if pool funds were being used to pay the pool operator's overhead, salary, and expenses, that would also have to be disclosed.

- Baker. (Plt. Ex. 24; E. Bloom, Tr. 298:4-8; *see also* M. Spear, Tr. 308:2-310:16). That amount represents interest earned on the funds at Sentinel. (J. Brodersen, Tr. 218:13-15).
103. Lake Shore offering memoranda and disclosure documents do not disclose that the interest would be paid to Hanford. (J. Brodersen, Tr. 219:9-18). Payment of interest to an entity affiliated with the Lake Shore's principal is proper if it is authorized and disclosed, as it is not unusual for an investment fund to direct payment to third parties. (E. Bloom, Tr. at 355:18-25). However, failure to disclose that interest is being retained for a purpose that creates a conflict of interest with investors is "a problem." (J. Brodersen, Tr. 264:13-20).
104. Plt. Exhibit 6 contains the following language: "LSAFA I, LSAFA II, and LSAFA III will not pay the Fund any interest on cash balances held by the Custodian." (Plt. Ex. 6 at CFTC Bates 100 06 0025). The document defines the Bank of New York as the custodian and defines "the Fund" as Lake Shore Alternative Financial Asset Fund IV Limited. (Plt. Ex. 6 at CFTC Bates 100 06 0021-22). According to Mr. Brodersen, this disclosure states that Funds I, II and III will not pay Fund IV interest on funds held by Bank of New York, but cannot be fairly understood to authorize or disclose that the income earned on the funds on deposit at Sentinel will be paid to an undisclosed entity controlled by Mr. Baker. (J. Brodersen, Tr. 264:13-20).
105. As noted above, interest from the Sentinel accounts was transferred to Hanford. Hanford, via a Bank of New York wire dated June 4, 2007, sent \$719,993.50 to Lefkada, Athens, Greece, for the purchase of real estate. (Plt. Ex. 27 at 2; M. Spear, Tr. 310:6-7). No evidence shows that investors were ever told that interest on fund accounts would be

given to a company run by a Lake Shore Limited principal to be used for the purchase of real estate.

106. Lake Shore Inc. has represented that “Lake Shore operates on a full disclosure basis.” (Plt. Ex. 8 at CFTC Bates 299 02 0011).

**H. Commissions on Accounts with Man**

107. On March 16, 2004, Man wrote letters to Lakeshore Alternative Financial Asset Ltd. and Hanford regarding Account No. 0120. The letters stated that during a routine review, Man noticed that profitability on the account had dropped by over \$1.1M and that the account was very actively traded. (Plt. Ex. 21 & 22). Mr. Brodersen testified that these letters showed that Man was concerned about the losses in the accounts and the commissions that were being charged to the accounts. (J. Brodersen, Tr. 272:2-14). The letters predate the formation of Lake Shore Limited.
108. Mr. Brodersen’s review of the letters showed that Account No. 0120 generated \$700,000 in commissions, which was a “very high commission-to-equity ratio.” He stated that churning occurs when an account is overtraded to generate commissions, and generally exists when commissions exceed an 18% commission-to-equity ratio. (J. Brodersen, Tr. 269:23-271:17).
109. In 2004, Hanford received a significant portion of the commissions charged to Fund I by Man. This rebate arrangement was not disclosed in any of the contemporaneous Lake Shore materials. (J. Brodersen, Tr. 271:18-272:1; Plt. Ex. 21).

**I. CFTC's Request to Inspect Lake Shore's Books and Records**

110. The CFTC and the NFA independently sought to inspect Lake Shore Limited's records to verify the trading results reported on Lake Shore's website. The regulators were also interested in reviewing trading records prepared by third parties, *i.e.*, the FCMs, because of the reliability of obtaining information from an outside source. (J. Brodersen, Tr. 168:9-13 and 169:7-9 and 182:15-21).
111. Lake Shore Limited has refused to permit inspection of its books and records by the NFA and the CFTC. In early July and through Alexander Schwab (a Swiss attorney), Lake Shore Limited told NFA and CFTC representatives that international law prevented Lake Shore from producing the trading and customer records requested by NFA and the CFTC. In regard to records that did not disclose customer identity, Mr. Schwab told Mr. Brodersen that he would have to inspect each record prior to production to ensure that production would not violate any international laws. Mr. Schwab indicated that this process would take him 3-5 weeks. (J. Brodersen, Tr. 183:20-25 and 184:1-11). As of this date, approximately eight weeks later, Mr. Schwab has not produced any records.
112. On July 2, 2007, Mr. Baker participated in a conference call relating to the CFTC and the NFA's efforts to audit Lake Shore Limited. During this call, Mr. Baker told CFTC and NFA staff that he did not know where Lake Shore Limited's records were located. When asked why the address for Lake Shore Limited in Toronto, Ontario, Canada provided on various account documents was a UPS store, Baker indicated that Lake Shore Limited had used the address temporarily while it attempted to develop an office. Mr. Baker was asked to provide the address or location of the records. Mr. Baker represented that he

would locate this information later that afternoon and inform the CFTC and the NFA.

However, at no time has Mr. Baker provided any information about the address or location of the records. (M. Spear, Tr. 62:16-63:18).

113. At no time has Lake Shore Limited or any representative provided any customer records, with the exception of certain records relating to Mr. Stoltz, in response to the CFTC's request under § 4n of the Act. (M. Spear, Tr. 64:2-5).

114. Lake Shore Limited did not explain its account naming conventions to the NFA during its analysis of the trading account records and track records produced by the FCMs. (J. Brodersen, Tr. 224:23-225:2). The analysis was complicated by the fact that the names of the accounts listed on the website did not always match the names of the accounts at the FCMs and some of the accounts did not appear to have corresponding trading accounts with matching names. (J. Brodersen, Tr. 225:2-20). In his 21 years of auditing commodity pools, Mr. Brodersen had never encountered naming conventions like those used by Lake Shore Limited. (J. Brodersen, Tr. 226:7-9).

115. The CFTC and the NFA have requested that Lake Shore provide information to support its performance results. Lake Shore has refused to do so. (Plt. Ex. 15, J. Brodersen Aff. at ¶ 24). Lake Shore Limited has provided no trading records that would permit the auditors to verify the information about Fund IV–U.S. that Lake Shore Limited gave to the Commission and the NFA. (J. Brodersen, Tr. 248:7-11). Lake Shore Limited has also not produced records in its possession that do not disclose the identity of its customers. (J. Brodersen, Tr. 184:2-8).

***The Amount Lake Shore Limited/Lake Shore Has Under Management***

116. In the Due Diligence, Lake Shore represented that it has approximately \$900 million in SMAs. (Plt. Ex. 5 at 11).
117. Mr. Rosenberg told the NFA auditors that Lake Shore has approximately \$1 billion under management. (Plt. Ex. 15, J. Brodersen Aff. at ¶ 10).
118. A Lake Shore document entitled “Assets Under Management” as of the end of June 11, 2007, attached to Mr. Brodersen’s affidavit, shows total assets under management equal to \$1.05 billion with just over \$290 million in the Lake Shore Alternative Financial Asset Funds and \$760 million in SMAs. (Plt. Ex. 15, J. Brodersen Aff. at ¶ 21).
119. In the July 2, 2007, telephone conversation with NFA and CFTC staff, Mr. Baker claimed that the firm had \$1 billion under management with approximately \$230 million invested in the funds and the remaining \$770 million in SMAs. (Plt. Ex. 15, J. Brodersen Aff. at ¶ 20). Lake Shore has not identified any SMAs to the CFTC or the NFA. (Plt. Ex. 15, J. Brodersen Aff. at ¶ 23). To date, the CFTC and NFA have only been able to identify one managed account invested outside of the Lake Shore Alternative Financial Asset Funds. (Plt. Ex. 15, J. Brodersen Aff. at ¶ 22). Specifically, Sentinel has an account named Lake Shore Alternative Asset Account II, which is part of the SMA that in turn is part of Lake Shore Fund II. (*See* the court’s chart at Exhibit 1; Plt. Ex. 13 & 18).
120. Lake Shore Limited does not have \$1 billion under management with the four FCMs. The FCM records indicate that the FCMs are holding approximately \$230M.

**K. Analysis of Lake Shore Alternative Financial Asset Funds I, II, III, and IV**

121. As noted above, Mr. Baker and Mr. Rosenberg stated that the Lake Shore Alternative Financial Asset Funds are traded through only three FCMs: Fimat, Man, and Lehman. (J. Brodersen, Tr. 190:21-191:7 and 261:8-13). The CFTC and the NFA obtained Lake Shore trading records from each of these FCMs. Mr. Brodersen testified that he had no reason to believe that he was missing trading records for any other accounts because Mr. Baker and Mr. Rosenberg stated that Fimat, Man, and Lehman were the prime brokers. Mr. Brodersen did, however, acknowledge that he did not have Lake Shore promotional materials for every year going back to 2002. (J. Brodersen, Tr. 232:1-7).
122. Neither the NFA nor the CFTC have received any account statements in the name of Futures Trading Group (“FTG”). (M. Spear, Tr. 85:20 – 86:1; J. Brodersen, Tr. 232:21-23). According to Mr. Baker, FTG is a non-U.S. company that was the predecessor to Lake Shore (it is unclear which “Lake Shore” entity this is). (J. Brodersen, Tr. 185:21-186:17).
123. Mr. Baker told Mr. Brodersen that he was doing business in Europe under the name FTG. Mr. Brodersen did not have records for any accounts held by FTG. He acknowledged that if other accounts were included in Lake Shore’s track record that he did not know about, it could change the track record. (*Id.* at 232:19-25).
124. Mr. Brodersen testified that he had no information indicating that the Lake Shore Group did business under a different name from 1994 to the present. Mr. Brodersen did not know if the Lake Shore Group ever traded under the name FTG. (J. Brodersen, Tr. 262:2-7).

125. Mr. Brodersen also testified that principals were required to disclose trading that had occurred in their other accounts as part of their track record. (*Id.* at 233:3-13). Contrary to Lake Shore Limited's suggestion, however, he did not state that principals were permitted to comingle results from different accounts held by unrelated funds without any sort of disclosure or explanation. (*Id.*).
126. If any of the Lake Shore Funds invested in an account in the name of FTG, if it was allowed, it would have to have been disclosed. (J. Brodersen, Tr. 274:9-16).
127. Although Lake Shore Limited's system for naming accounts was confusing, Mr. Brodersen testified that this did not impact his ability to identify accounts or track the performance of those accounts. (J. Brodersen, Tr. 236:8-16).
128. It is possible for a fund to invest in its own trading account and another fund's trading account. In this instance, the first fund's performance would be a blend of both funds' performances, but this constitutes illegal commingling. (J. Brodersen, Tr. 236:16-21). However, a fund can invest in another fund (*i.e.*, a fund of fund investment). If this occurred with the Lake Shore Alternative Financial Asset Funds, to know a particular fund's performance, an auditor would have to look at both funds' performance and their trading accounts. (J. Brodersen, Tr. at 236:22-238:14). Mr. Brodersen reviewed the trading performance of all the funds. (Plt. Ex. 18).
129. Mr. Brodersen reviewed documents from the trading accounts at the three trading FCMs. From this review, he ascertained that the Lake Shore Alternative Financial Asset Funds had lost money overall. Regardless of whether he knew about all possible fund of fund transfers, he testified that Lake Shore represented that all of the Lake Shore Alternative

Financial Asset Funds were profitable. He then concluded that even without information about possible fund to fund transfers, overall profitability was the critical inquiry because overall, the accounts lost money. In other words, since all of the Lake Shore Alternative Financial Asset Funds were shown as profitable, he found that there was no place for losing trades to go to explain the overall profitability regardless of any fund to fund transfers. (*Id.*).

130. Mr. Brodersen was unable to square the fact that all seven Lake Shore Alternative Financial Asset Funds were said to be profitable with the fact that the trading accounts at the three trading FCMs for the Lake Shore Alternative Financial Asset Funds lost \$29 million. (J. Brodersen, Tr. at 264:4-12).
131. As of June 11, 2007, Lake Shore records showed that the U.S. investor in Lake Shore Alternative Financial Asset Fund IV (via Fund IV U.S.) had a balance of \$1,015,324.29. That investor deposited \$1M in May of 2007, so the June figure would show the profit made in May through June 11, 2007. In May of 2007, Lake Shore Alternative Financial Asset Fund IV had a negative performance. (J. Brodersen, Tr. 268:1-25). Because Fimat's records were dated May 31, 2007, Mr. Brodersen was unable to analyze Lake Shore Alternative Financial Asset Fund IV's June 2007 profitability.
132. Funds overall are not interchangeable with the trading accounts. Thus, an investment manager would not focus on money coming in and out of a fund. Instead, he would be concerned with the money in the trading account, and would know the amount of funds in the trading account and how much he/she can access for trading. (J. Brodersen, Tr. 242:1-5, 10-13).

133. With respect to the monies at Sentinel, Mr. Brodersen testified that there were a number of transactions between funds which appeared to be irregular since an FCM cannot commingle the funds of one commodity pool with another. (J. Brodersen, Tr. 244:9-10). He conceded that it would be possible for the transfers to be proper because they could be fund to fund transfers, represent a feeder fund, or flow from an investor's decision to change strategy, but stated that this type of activity warranted further investigation. (J. Brodersen, Tr. 245:1-14, 247:2-11).
134. The fact sheet for Lake Shore Alternative Financial Asset Fund IV states that the manager's investment objective "is to maximize returns while preserving capital" by investing equally in Lake Shore Fund I, II, and III. (Plt. Ex. 19 at 221 04 0157). In other words, money from Lake Shore Alternative Financial Asset Fund IV flows towards Lake Shore Alternative Financial Asset Funds I, II, and III.
135. When a CPO opens up an account with a trading firm, it opens that account in the name of the fund, not its own name, because the fund has to be a separate legal entity. (J. Brodersen, Tr. 249:25-250:2).
136. In response to questions from Lake Shore Limited's counsel, Mr. Brodersen conceded that his analysis of Lake Shore Limited's accounts might change if Lake Shore Limited provided all of its records. (J. Brodersen, Tr. 245:15-246:2).
137. The fact that somebody loses money trading does not in and of itself show that anything is wrong. (J. Brodersen, Tr. 251:11-16).

138. Mr. Brodersen analyzed over five years of Man’s trading accounts. (J. Brodersen, Tr. 251:25-252:2). During this time, Man sent two letters due to its concern about churning. (*Id.* at 252:7-16).
139. Mr. Brodersen testified that he had not seen support for Lake Shore Limited’s simulated trading figures. He also stated that under NFA regulations, it is impermissible to use simulated results if they do not comport with the actual results, and if actual results for three months existed, it was impermissible to use simulated results at all. However, he also acknowledged that NFA regulations only apply to NFA members or funds doing business in the U.S. (J. Brodersen, Tr. at 253:9-21 and 254:1-6).
140. Lake Shore Limited’s “Assets Under Management” as of June 11, 2007 consist of:

Total 1.05B					
LS I 492.0M		LS II 369.0M		LS III 116.5M	
SMA 419.0M	LSAFA Fund I 73.0M	SMA 338.0M	LSAFA Fund II 31.0M	LSAFA Fund III 116.5M	LSAFA Fund IV 73.0M

(See the chart attached to Plt. Ex. 15). The reader may also wish to refer to Ex. 1 to this order for a more complete depiction of the Lake Shore funds’ structure.

141. Lake Shore Funds I and II contain SMAs as well as Lake Shore Alternative Financial Asset Fund I and II, respectively. Lake Shore Funds III and IV consist of Lake Shore Alternative Financial Asset Fund III and IV, respectively. The FCMs with the accounts for Lake Shore Alternative Financial Asset Funds I, II, III, and IV have given their records to the CFTC and the NFA. Based on Lake Shore Limited’s own chart depicting the

distribution of monies, therefore, the FCMs' records for Lake Shore Alternative Financial Asset Funds I, II, III, and IV should reflect the monies in those accounts, and the trading FCM records from Fimat, Man, and Lehman should reflect the trades for Lake Shore Alternative Financial Asset Funds I, II, III, and IV. Thus, Lake Shore Limited's contention that the CFTC cannot conduct an accurate audit of Lake Shore Alternative Financial Asset Funds I, II, III, and IV due to lack of complete records incorrect because there are no SMAs associated with the accounts for those funds.

142. It is undisputed that neither the CFTC nor the NFA have complete records for the Lake Shore Funds because Lake Shore Limited refused to turn over its records. For the Lake Shore Alternative Financial Asset Funds, the CFTC and the NFA have records from the FCMs but no records from Lake Shore Limited.
143. In response to questions from Lake Shore Limited's counsel, Ms. Spear stated that it is possible that the Lake Shore Group or Lake Shore Limited have accounts with custodians other than Man, Lehman, Sentinel, and Fimat. (M. Spear, Tr. 83:20 – 84:14). However, both Mr. Baker and Mr. Rosenberg stated that the Lake Shore Alternative Financial Asset Funds are traded through only three FCMs: Fimat, Man, and Lehman. (J. Brodersen, Tr. 190:21-191:7 and 261:8-13).
144. Mr. Baker has also stated in a declaration that the NFA and CFTC do not have all of the prime brokerage statements needed to verify the performance and assets of the Lake Shore Funds. (Second Declaration of P. Baker, Def. Ex. 11, at ¶ 2). This is true to the extent that the CFTC and the NFA do not have complete records for Lake Shore Funds I, II, III, and IV. In contrast, the CFTC and the NFA have records from the 4 FCMs

identified by Mr. Baker and Mr. Rosenberg for the Lake Shore Alternative Financial Asset Funds. The FCM records can be used to assess the performance of the Lake Shore Alternative Financial Asset Funds, which are the relevant funds. In this regard, reference to the court's chart, which depicts this graphically, may be helpful. (*See Exhibit 1*).

145. The Lake Shore Alternate Financial Asset Fund II fact sheet states that this fund started trading in January 2005 and provides what purports to be actual trading results. (Plt. Ex. 19 at 221 04 0117). The NFA was only able to locate trading statements for this account beginning in October 2006 based on the FCM records, which presumably reflect all of the activity that occurred with the accounts associated with this fund. (J. Brodersen, Tr. 201:9-20).
146. The NFA and the CFTC do not have all of the records related to the Lake Shore Group of Companies due to Lake Shore Limited's position that it is not required to turn over these records. (J. Brodersen, Tr. 231:2-6).
147. In addition, the CFTC and NFA do not have Lake Shore's promotional materials for 2002, 2003, 2004 and 2005. (J. Brodersen, Tr. 231:2-6; 232:10-17).
148. A search by NFA for NFA members with accounts for any Lake Shore Group of Companies funds would not pick up brokerage firms outside of the United States who are not NFA members. (J. Brodersen, Tr. 276:17-19).
149. The NFA has not received all of the information it normally would receive when conducting an audit because the entity being audited normally allows access to its records. (J. Brodersen, Tr. 245:15-24). If the NFA or CFTC were to receive more

information, it is possible that their calculations could change. (J. Brodersen, Tr. 245:25-246:2).

## II. Conclusions of Law

### A. Standard for a Preliminary Injunction Under Rule 65 and 7 U.S.C. § 13a-1

“It frequently is observed that a preliminary injunction is an extraordinary and drastic remedy, one that should not be granted unless the movant, *by a clear showing*, carries the burden of persuasion.” *Mazurek v. Armstrong*, 520 U.S. 968, 972 (1997) (emphasis in original), *quoting* 11A Charles Alan Wright, Arthur R. Miller, & Mary Kay Kane, FEDERAL PRACTICE AND PROCEDURE § 2948, pp. 129-30 (2d ed. 1995). To obtain a preliminary injunction under Rule 65, the movant must show (1) it is reasonably likely to succeed on the merits; (2) no adequate remedy at law exists; (3) it will suffer irreparable harm that outweighs any harm the nonmoving party will suffer if the injunction is granted; and (4) the injunction will not harm the public interest. *Christian Legal Society v. Walker*, 453 F.3d 853, 859 (7th Cir. 2006).

If the moving party meets this threshold burden, the court exercises its discretion by weighing the factors against one another in a sliding scale analysis to determine if the balance of harms weighs in favor of the moving party or whether the nonmoving party or public interest will be harmed sufficiently that the injunction should be denied. *See id.*; *Cavel International, Inc. v. Madigan*, No. 07-2658, — F.3d —, 2007 WL 2239215, at \*2 (7th Cir. Jul. 18, 2007) (discussing sliding scale analysis).

Thus, a party seeking a preliminary injunction must establish that it will be irreparably harmed absent the granting of relief. *See Re/Max North Central, Inc. v. Cook*, 272 F.3d 424, 433 (7th Cir. 2001) (affirming denial of the defendant’s motion for a preliminary injunction where,

among other things, the record failed to show that without an injunction, the defendant would personally suffer irreparable harm). This requirement seems to present a quandary for a regulatory body such as the CFTC, which files suit to protect individuals and entities whom it believes may be harmed by the violation of federal statutes governing futures trading but suffers no personal harm from the violation of those statutes.

The solution, however, is simple: 7 U.S.C. § 13a-1 authorizes the CFTC to seek injunctive relief against an entity which “has engaged, is engaging, or is about to engage in any act or practice constituting a violation of any provisions of the Act or any rule, regulation or order thereunder.” Irreparable injury to the CFTC is presumed in a statutory enforcement action, *Wisconsin v. Stockbridge-Munsee Community*, 67 F.Supp.2d 990, 995-96 (E.D. Wis. 1999), although the court must also consider whether the record establishes that the financial interests of the investors (the people who are ultimately harmed if the CFTC’s allegations are well-founded) are in jeopardy. See *Commodity Futures Trading Com’n v. Lake Shore Asset Management Ltd.*, No. 07-2790, — F.3d —, 2007 WL 2206862, at \*3 (7th Cir. Aug. 2, 2007).

Thus, the CFTC is entitled to injunctive relief upon a prima facie showing that: (1) a violation of the Commodity Exchange Act has occurred; and (2) “there is some reasonable likelihood of future violations.” *Commodity Futures Trading Com’n v. Hunt*, 591 F.2d 1211, 1220 (7th Cir. 1979). Past misconduct is “highly suggestive of the likelihood of future violations.” *Id.* (internal quotations omitted); *SEC v. Holschuh*, 694 F.2d 130, 144-45 (7th Cir.1982) (an injunction prohibiting a party from engaging in conduct that violates the provisions of a statute is appropriate when there is a likelihood that, unless enjoined, the violations will continue).

When determining if future violations are likely, the court should also consider the “totality of the circumstances” surrounding the defendant’s violations, including the nature of the violations, whether the violations are isolated or recurrent, the defendant’s recognition of the wrongfulness of its conduct, and the likelihood that the defendant’s customary business activities will present opportunities for future violations. *Id.*; *see also Commodity Futures Trading Com’n v. American Bd. of Trade, Inc.*, 803 F.2d 1242, 1251 (2d Cir. 1986).

**B. The Lake Shore Common Enterprise and Lake Shore Limited’s Status as a Mere Continuation of that Enterprise**

The court will begin by considering whether: (1) Lake Shore Limited is a mere continuation of Lake Shore Inc.; or (2) the various Lake Shore entities have acted as a common enterprise. The resolution of these issues is necessary to determine what would normally be the court’s first concern: the extent of the CFTC’s ability under the Act to challenge actions taken by Lake Shore Limited.

**1. Lake Shore Limited is the Mere Continuation of Lake Shore Inc., and so The Mere Continuation Exception to Successor Nonliability Applies**

A successor corporation is a corporation that has acquired all the assets of another corporation which then dissolves. *See Brandon v. Anesthesia & Pain Mgt. Assocs., Ltd.*, 419 F.3d 594, 599 (7th Cir. 2005). Although the successor corporation acquires the predecessor’s assets, it normally does not inherit the predecessor’s liabilities. *Id.* However, under the “mere continuation” exception, a successor corporation that is the mere continuation of the predecessor corporation does not escape liability for the predecessor’s conduct. *Id.*

Under federal common law, there is no rigid test to determine whether one corporation is the mere continuation of a predecessor; rather courts take a common-sense approach that takes into account any fact that is relevant in light of the unique situation each case presents. *See North Shore Gas Co. v. Salomon Inc.*, 152 F.3d 642, 654 (7th Cir. 1998) (“The mere continuation exception requires close scrutiny of corporate realities, not mechanical application of a multi-factor test”). Facts that courts have found to be significant include the following: (1) the successor has the same or similar management and ownership as the predecessor; (2) only the successor remains in existence; (3) there is an apparent continuity from the predecessor to the successor based upon the same personnel and location; (4) the successor has marketed itself and held itself out to the world as the continuation of the predecessor; and (5) the successor has operated under a name similar to its predecessor in order to rely on the goodwill associated with the predecessor’s name. *Id.*; *Kozlowski v. Skyhook Corp.*, No. JFM-84-3536, 1986 WL 110686, at \*\*2-3 (D. Md. Jul. 18, 1986); 15 William M. Fletcher, FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS, § 7124.10; *see also Brandon v. Anesthesia & Pain Mgt. Assocs., Ltd.*, 419 F.3d at 599 (“there can be continuation without formal successorship. ‘Continuation’ is just a less colorful name for the ‘changed name,’ ‘different clothes,’ or ‘new hat’ rule.”).

Based upon its close examination of the facts, including the testimony of witnesses and documentary evidence, the court concludes that Lake Shore Limited is a mere continuation of Lake Shore Inc. First, Lake Shore Limited and Lake Shore Inc. (and, indeed, all of the Lake Shore entities) have overlapping management and ownership. Second, Lake Shore Limited expressly represented that it was a reorganization of Lake Shore Inc. and after the reorganization, Lake Shore Inc. ceased to exist. Third, Lake Shore Limited and Lake Shore Inc. have the same

Chicago office address and very similar names. Last but not least, Lake Shore Limited took over the Lake Shore Funds and the Lake Shore Alternative Financial Asset Funds from Lake Shore Inc. Thus, Lake Shore Limited appears to be carrying on the business of Lake Shore Inc. under a new name. This is especially true since Lake Shore Inc. was the firm name for Lake Shore Alternative Investment, which is 100% owned by Senior Management of Lake Shore Asset Management, the same management who served as principals in Lake Shore Limited.

In sum, the court's study of the record and its consideration of the witnesses' testimony during the preliminary injunction hearing leaves the court with the firm conviction that the CFTC will ultimately establish that Lake Shore Limited is a mere continuation of Lake Shore Inc. There is no evidence to the contrary, other than the fact that Lake Shore Limited and Lake Shore Inc. were formed as separate entities. Contrary to Lake Shore Limited's suggestion, this is not dispositive as to whether Lake Shore Limited is the mere continuation of Lake Shore Limited because it has long been recognized that the fiction of separate corporate existence does not shield a corporation from liability for fraud. *J.J. McCaskill Co. v. United States*, 216 U.S. 504, 514-15 (1910). In light of the factors discussed above, the court thus concludes that Lake Shore Limited is a mere continuation of Lake Shore Inc. This makes the mere continuation exception applicable, so Lake Shore Limited is liable for the conduct of Lake Shore Inc.

**2. The Lake Shore Entities Were Operated as a Common Enterprise, and so Lake Shore Limited is Liable for the Conduct of Each Enterprise**

Alternatively, Lake Shore Limited is liable for the conduct of Lake Shore Inc. and all of the numerous Lake Shore entities under the "common enterprise" theory of liability. Under that theory, companies that operate as a common enterprise are liable for the deceptive acts and

practices of the other members of the enterprise. *See Commodity Futures Trading Com'n v. Wall Street Underground, Inc.*, 281 F. Supp. 2d 1260, 1271 (D. Kan. 2003); *see also Federal Trade Com'n v. Bay Area Business Council*, No. 02 CV 5762, 2004 WL 769388, at \*12 (N.D. Ill. Apr. 9, 2004). In order to determine whether entities have operated as a common enterprise, and thus whether they are liable for each other's conduct, courts look to the following factors: (1) whether the companies are under common control or operate at arms-length; (2) whether they share office space; (3) whether they transact business through a maze of interrelated companies; and (4) whether they commingle funds. *See Commodity Futures Trading Com'n v. Int'l Berkshire Group*, No. 05-61588, 2006 WL 3716390, at \*7 (S.D. Fla. Nov. 3, 2006); *Bay Area Business*, 2004 WL 769388, at \*12.

A common enterprise can consist of a combination of predecessor corporations and their successors. In that event, the successors and predecessors are all jointly and severally liable for the conduct of each other. *See Commodity Futures Trading Com'n v. Noble Wealth Data Info. Serv., Inc.* 90 F. Supp. 2d 676, 690 (D. Md. 2000) (where two firms were formed as successors to a predecessor firm, and where they were all operated by the same individuals and used the same marketing materials, all three firms were jointly and severally liable for each others' violations of the Commodity Exchange Act), *aff'd in part and vacated in part on other grounds, sub nom., Commodity Futures Trading Com'n v. Baragos*, 278 F.3d 319 (4th Cir. 2002).

After carefully reviewing the facts in light of the relevant factors set forth above, the court concludes that the Lake Shore entities operated as a common enterprise:

- Lake Shore Group's promotional materials refer to "Lake Shore," the Lake Shore Group, Lake Shore Inc., and Lake Shore Limited interchangeably.

- The Pitch produced to the CFTC by Mr. Eveleigh refers repeatedly and collectively to “Lake Shore” and includes a variety of Lake Shore entities under that umbrella.
- Mr. Baker is: (1) the Managing Director, Principal and President of Lake Shore Limited; (2) the co-founder and managing partner of the Lake Shore Group of Companies and Lake Shore Institutional & Dealer Relations; (3) the contact person for Lake Shore Limited listed in its Due Diligence; (4) the Managing Partner of the Lake Shore Inc.; and (5) the person with primary responsibility for managing Lake Shore Limited and the Lake Shore Group of Companies’ overall international business development, operations, sales and marketing.
- Lake Shore Inc. and Lake Shore Limited were both located at 875 N. Michigan Ave., Suite 1562, Chicago, Illinois. Lake Shore Group letterhead states that it has offices in Chicago without providing a specific address. Lake Shore Limited and Lake Shore Group’s management personnel are located in Chicago, and have administrative/IT/operations staff, and execution staff in Chicago.
- A document on Lake Shore Group’s letterhead entitled “Qualitative Firm Evaluation & Due Diligence Lake Shore Asset Management Limited” (“Due Diligence”) states that Lake Shore Limited’s web address is [www.lakeshorefunds.com](http://www.lakeshorefunds.com).
- Information and performance results for the funds managed and advised by Lake Shore Limited are available on Lake Shore Group’s website.
- A Lake Shore Limited press release dated January 29, 2007, was on Lake Shore Group letterhead, referred to [www.lakeshorefunds.com](http://www.lakeshorefunds.com), and did not distinguish between Lake Shore Group and Lake Shore Limited. It also announced Lake Shore Limited’s launch of Fund IV and touted the 13-year history of “Lake Shore.”
- Lake Shore Limited and Lake Shore Inc.’s printed materials relating to the Lake Shore Alternative Financial Asset Funds are on Lake Shore Group stationery and contain Lake Shore Group’s logo.
- Lake Shore Limited solicited customers through dealers affiliated with Lake Shore Group.
- Mr. Rosenberg told NFA staff that the Lake Shore Group is comprised only of Lake Shore Limited. This is consistent with the organizational chart contained in the Pitch.

- The Pitch shows that Lake Shore Limited provides or manages all of the Lake Shore Group's products: Lake Shore Alternative Asset Account I, Lake Shore Alternative Asset Account II, Lake Shore Alternative Financial Asset Funds I, II, III and IV and Lake Shore Alternative Financial Asset Yen Fund.

In short, this case is the poster child for the transaction of business through a maze of interrelated companies, and all of the evidence presented to the court indicates that all of the Lake Shore companies (with the exception of Mr. Church's Lake Shore Inc., which may not be the same as the Lake Shore Group's Lake Shore Inc.) were under common control and did not operate at arms-length. The reasonable inference is that Lake Shore Alternative Financial Asset Funds I, II, III, and IV are also all part of the Lake Shore common enterprise and inextricably related to Lake Shore Limited.

Corporate formalities are not binding when a corporation is part of a common enterprise, so Lake Shore Limited's argument in response – that it was incorporated in Bermuda in 2006 – is unpersuasive. *See J.J. McCaskill Co. v. United States*, 216 U.S. at 514-15. The court is also not persuaded by Lake Shore Limited's claim that Mr. Baker and the other overlapping principals in the various Lake Shore entities could have been acting properly when handling monies because they could have been acting in their capacities as principals of separate enterprises. The key words here are "could have" – the CFTC's evidence strongly supports an inference that the entities were all one common enterprise, and Lake Shore Limited has presented no evidence supporting its spin on this evidence. The court thus finds that the CFTC is likely to prevail on its claim that the Lake Shore entities operated as a common enterprise and hence each entity is liable for the conduct of the others. *See Wall Street*, 281 F. Supp. 2d at 1271; *Bay Area Business*, 2004 WL 769388, at \*12.

**3. Effect of Lake Shore Limited's Liability for Conduct of Lake Shore Inc. Both as a Mere Continuation and Under the Common Enterprise Theory**

Because the Lake Shore entities operated as a common enterprise, and because Lake Shore Limited is the mere continuation of Lake Shore Inc., there is no meaningful distinction between any of these entities. *See Commodity Futures Trading Com'n v. Equity Fin. Group, LLC*, No. 04 CV 1512, 2007 WL 2198805, at \*2 (D. N.J. June 28, 2007) ("In substance, there is no meaningful distinction among the entities, which operated as a common enterprise."). As a result, Lake Shore Limited is as equally liable for the conduct of Lake Shore Inc. and the other Lake Shore entities as it is liable for its own conduct.

Nevertheless, defendant Lake Shore Asset Management Limited contends that: (1) it is under no obligation to produce the records of the other Lake Shore entities because the other entities are not parties to this suit; and (2) the court has no injunctive powers over the other Lake Shore entities because they are not parties to this suit. These contentions are unfounded. As the court has already concluded based upon the facts as set forth above, the Lake Shore entities are indistinguishable: they operated as a common enterprise, and in addition Lake Shore Asset Management Limited is the mere continuation of Lake Shore Asset Management, Inc. Accordingly, the court has the power not only to enjoin named defendant Lake Shore Asset Management Limited, but also the other Lake Shore entities that formed the common enterprise. *See Commodity Futures Trading Com'n v. Wall Street Underground, Inc.*, No. 04-3131, 2005 WL 958476, at \*2 (10th Cir. Apr. 27, 2005) (affirming preliminary injunction against an entity

that was not a CTA subject to CFTC oversight, but which participated in a common enterprise with a CTA).<sup>4</sup>

**C. The CFTC's Ability to Regulate Lake Shore Limited's Activities as a CTA and CPO**

This court has jurisdiction because the CFTC filed suit under 7 U.S.C. § 13-1(a), which provides that, “[w]henver it shall appear to the Commission that any registered entity or other person has engaged, is engaging, or is about to engage in any act or practice constituting a violation of any provision of this chapter or any rule, regulation, or order thereunder, or is restraining trading in any commodity for future delivery, the Commission may bring an action in the proper district court of the United States ... to enjoin such act or practice, or to enforce compliance with this chapter, or any rule, regulation or order thereunder, and said courts shall have jurisdiction to entertain such actions ....” Venue is proper in this district because Lake Shore Limited has offices in Chicago. *See* 7 U.S.C. § 13-1(e).

Lake Shore Limited is a “registered entity” because on January 17, 2007, it registered as a CPO and CTA with the CFTC. *See* 7 U.S.C. § 1a(5) (defining a CPO); 7 U.S.C. § 1a(6) (defining a CTA). As discussed above, Lake Shore Limited was a mere continuation of the Lake Shore common enterprise, which included Lake Shore Inc., which also was a CFTC registrant and NFA member.

Above and beyond Lake Shore Limited and Lake Shore Inc.'s status as CFTC registrants, Lake Shore Limited's promotional materials repeatedly state that it is doing business as a CFTC

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<sup>4</sup> The court does not mean to suggest by its citation to the *Wall Street Underground* case that it believes that Lake Shore Inc. did not act as a CTA. Instead, the citation goes to the court's power to enjoin the entities comprising a common enterprise.

registrant and NFA member, that it is the trading manager for the Lake Shore Alternative Financial Asset Funds, and that it is a registered CPO and CTA. Lake Shore Limited's documents also indicate that the Lake Shore Alternative Financial Asset Funds would trade commodity futures contracts on U.S. exchanges, and contracts were traded on U.S. exchanges including the Chicago Mercantile Exchange, the Chicago Board of Trade, and the New York Mercantile Exchange. In addition, Lake Shore Limited told at least one FCM that it was a NFA member.<sup>5</sup> Next, the account statements from Fimat, Lehman and Man and the funds' fact sheets show that the funds in fact traded at least in part on U.S. exchanges. Finally, a substantial amount of losses at Man, Fimat and Lehman (the only three trading accounts for the Lake Shore Alternative Financial Asset Funds) occurred as the result of trading on U.S. futures exchanges.

Lake Shore Limited nevertheless contends that the fact that the trading FCMs are located in London and it is a Bermuda corporation means that the CFTC is overstepping its bounds when it seeks Lake Shore Limited's records. In the seminal case of *Tamari v. Bache & Co. (Lebanon) S.A.L.*, 730 F.2d 1103 (7th Cir. 1984), the Seventh Circuit confronted a similar argument, as the defendant contended that the court lacked subject matter jurisdiction under the Act over a dispute between nonresident aliens involving trades within the United States because the parties' other contacts took place outside the country. *Id.*

The Seventh Circuit held that subject matter jurisdiction over international disputes concerning commodity futures transactions exists if either the "conduct" or "effects" tests are met. *Id.* at 1108; *Pyrenee, Ltd. v. Wocom Commodities, Ltd.*, 984 F.Supp. 1148, 1155 (N.D. Ill.

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<sup>5</sup> More specifically, account opening documents at Man for Lake Shore Alternative Financial Asset Fund IV, Ltd. dated March 26, 2007, state that this company is authorized by the NFA. The document then provides Lake Shore Limited's NFA identification number.

1997) (collecting cases holding that the tests are alternative). The conduct test focuses on conduct within the United States that relates to the alleged fraud and authorizes jurisdiction when that conduct “is material to the successful completion of the alleged scheme.” *Id.* In turn, the effects test considers whether foreign activities have “caused foreseeable and substantial harm to interests in the United States.” *Id.*

To establish jurisdiction under the conduct test, the plaintiff must point to some United States activity by the defendant. *Mak v. Wocom Commodities Ltd.*, 112 F.3d 287, 289 (7th Cir. 1997); *Tamari v. Bache & Co. (Lebanon) S.A.L.*, 730 F.2d at 313. Although Lake Shore Limited and the other Lake Shore companies are not incorporated in the United States, activities relating to the alleged scheme to defraud occurred in the United States. *See Mak v. Wocom Commodities Ltd.*, 112 F.3d at 289 (“the transmission of commodity futures orders to the United States from foreign parties is an essential step in the consummation of any scheme to defraud through futures trading on the United States exchanges.”). As will be discussed in detail below, the evidence demonstrates that the CFTC has a likelihood of establishing that Lake Shore Limited used U.S. exchanges to facilitate a fraud, even if the individual transactions themselves were not fraudulent. Accordingly, Lake Shore’s attempt to distinguish the *Tamari* case based on the fact that no evidence shows that the individual transactions themselves were fraudulent is unpersuasive.

Moreover, Lake Shore Inc., which was part of the Lake Shore common enterprise, and Lake Shore Limited, the continuation of the Lake Shore common enterprise, were both CFTC registrants and, as discussed in more detail below, acted as CTAs and CPOs in connection with the Lake Shore Alternative Financial Asset Funds. The CFTC has jurisdiction to address the conduct of its own registrants. *See 7 U.S.C. § 2(a)(1)(A); Merrill Lynch, Pierce, Fenner &*

*Smith, Inc. v. Curran*, 456 U.S. 353, 360-67 (1982) (discussing history of the Act and noting that it grants broad powers to the CFTC to administer and enforce the Act).<sup>6</sup>

Lake Shore Limited's status as a Bermuda corporation, its use of FCMs in London, and the presence of foreign investors or foreign brokerage firms therefore do not somehow turn this case into an effort by the CFTC to regulate foreign futures trading. In other words, the CFTC is not, contrary to Lake Shore Limited's assertion, trying to use the Act to investigate foreign companies associated with Lake Shore Limited that are outside the jurisdiction of this court and the CFTC under the Act. *See Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 667 (7th Cir. 1998) (in analogous securities fraud context, stating that the court must distinguish between "situations in which the United States is being used as a launching pad for fraudulent international securities schemes" and "disputes which have little in the way of a significant connection to the United States" and holding that jurisdiction is proper if conduct within the U.S. "forms a substantial part of the alleged fraud and is material to its success").

This is especially true given that the court is considering whether to grant a preliminary injunction and the record reflects trading activity in the U.S. and actions taken as a CTA and CPO. On the other side of the balance, Lake Shore Limited argues that its U.S. activities are insubstantial compared to its foreign activities, but does not offer any evidence supporting such

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<sup>6</sup> In this regard, it is disingenuous for Lake Shore Limited to repeatedly tout its status as a CFTC registrant and NFA member in its marketing materials to lend credibility to its operations and then contend that the CFTC lacks jurisdiction to regulate its activities. Indeed, in addition to the numerous representations about its CFTC registration and NFA membership, Lake Shore Limited's Alternative Investment Due Diligence Questionnaire even advised future clients that "[r]elying on statements from Lake Shore and its regulatory history provides the comfort available," as opposed to receiving redacted information about performance from past or existing clients.

an inference except its claim that its only U.S. activity involves the single U.S. investor who invested in a U.S. feeder fund, which the court has rejected. In short, the court finds that the CFTC has met its burden of showing that Lake Shore Limited's U.S. activities are sufficient to confer jurisdiction under the Act.

**D. Lake Shore Limited's Records**

Section 4n(3)(A) of the Commodity Exchange Act, 7 U.S.C. § 6n(3)(A), provides:

Every commodity trading advisor and commodity pool operator registered under this chapter shall maintain books and records and file such reports in such form and manner as may be prescribed by the Commission. All such books and records shall be kept for a period of at least three years, or longer if the Commission so directs, and shall be open to inspection by any representative of the Commission or the Department of Justice. Upon the request of the Commission, a registered commodity trading advisor or commodity pool operator shall furnish the name and address of each client, subscriber, or participant, and submit samples or copies of all reports, letters, circulars, memorandums, publications, writings, or other literature or advice distributed to clients, subscribers, or participants, or prospective clients, subscribers, or participants.

*See also* 17 C.F.R. § 1.31 (keeping and inspection of books and records).

Lake Shore Limited has produced certain records relating to its single U.S. investor and the single U.S. Fund (Fund IV–U.S.). The CFTC contends that this is not enough and that Lake Shore Limited must also allow inspection of Lake Shore Limited's records as well as records of other Lake Shore entities.

**1. Lake Shore Limited's Production of its Own CTA/CPO Records Post-Dating its CFTC Registration**

The Act's record keeping requirements apply to CTAs and CPOs registered with the CFTC. Thus, for an entity to be liable under the record keeping provision, the record must show that it: (1) was registered as either a CPO or a CTA, and (2) was acting as either a CPO or a

CTA. *New York Currency Research Corp. v. Commodity Futures Trading Com'n*, 180 F.3d 83, 89 (2d Cir. 1999). It is undisputed that on January 17, 2007, Lake Shore Limited became registered with the CFTC as a CTA and CPO to do business within the United States. Lake Shore Limited, however, claims that it never acted as a CTA or CPO due to the filing of this action.

A CTA is:

(A) ... any person who –

(I) for compensation or profit, engages in the business of advising others, either directly or through publications, writings, or electronic media, as to the value of or the advisability of trading in –

(I) any contract of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market or derivatives transaction execution facility;

(II) any commodity option authorized under section 6c of this title; or

(III) any leverage transaction authorized under section 23 of this title; or

(ii) for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (I).

(B) Exclusions. Subject to subparagraph (C), the term “commodity trading advisor” does not include –

(I) any bank or trust company or any person acting as an employee thereof;

(ii) any news reporter, news columnist, or news editor of the print or electronic media, or any lawyer, accountant, or teacher;

(iii) any floor broker or futures commission merchant;

(iv) the publisher or producer of any print or electronic data of general and regular dissemination, including its employees;

(v) the fiduciary of any defined benefit plan that is subject to the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1001 et seq.);

(vi) any contract market or derivatives transaction execution facility; and

(vii) such other persons not within the intent of this paragraph as the Commission may specify by rule, regulation, or order.

(C) Incidental services. Subparagraph (B) shall apply only if the furnishing of such services by persons referred to in subparagraph (B) is solely incidental to the conduct of their business or profession.

(D) Advisors. The Commission, by rule or regulation, may include within the term “commodity trading advisor”, any person advising as to the value of commodities or issuing reports or analyses concerning commodities if the Commission determines that the rule or regulation will effectuate the purposes of this paragraph.

7 U.S.C. § 1a(6)

In turn:

The term “commodity pool operator” means any person engaged in a business that is of the nature of an investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in any commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility, except that the term does not include such persons not within the intent of the definition of the term as the Commission may specify by rule, regulation, or order.

7 U.S.C. § 1a(5).

The documents in this case are replete with representations by Lake Shore Limited that it is the trading manager for the Lake Shore Alternative Financial Asset Funds as well as a CFTC-registered CTA and CPO, and that Lake Shore Limited is the reorganized version of Lake Shore Inc. Importantly, the evidence also shows that Lake Shore Limited acted on behalf of *all* of the Lake Shore Funds/Lake Shore Alternative Asset Funds, not just Fund IV-U.S. The court finds that this evidence establishes that Lake Shore Limited acted as a CTA because it was engaged in the business of directly advising others regarding the value of or the advisability of trading in the

futures market. Similarly, it establishes that Lake Shore Limited acted as a CPO because it was engaged in a business that is of the nature of an investment trust, syndicate, or similar form of enterprise, and in connection therewith, solicited, accepted, or received funds from others for the purpose of engaging in futures trading.

The only contrary evidence about Lake Shore Limited's status as the Lake Shore Alternative Financial Asset Funds' CTA is Mr. Baker's testimony via declaration that Lake Shore Group intended Lake Shore Limited to act as the funds' investment advisor, but this plan was not carried out as a result of this action and a parallel action by the NFA. This declaration does not address Lake Shore Limited's representations in its own documents supporting an inference that it acted as a CPO.

The court also finds that Mr. Baker's assertion that Lake Shore Limited never acted as the funds' CTA is incredible. Specifically, FCM records show that the accounts for the Lake Shore Alternative Financial Asset Funds were being traded in 2007 through the date of the original asset freeze (which was subsequently vacated) and the ongoing NFA asset freeze. Thus, the filing of this action and the NFA action in June of 2007 post-date substantial amounts of trading activity earlier in 2007. In addition, numerous Lake Shore documents showing that Lake Shore Limited was the Lake Shore Alternative Financial Asset Funds' CTA and CPO predate the institution of this action and the separate NFA action. The court infers from these facts that Lake Shore Limited acted as the funds' CTA and the CPO, given the complete lack of any credible evidence to the contrary.<sup>7</sup>

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<sup>7</sup> The court also clarifies that Lake Shore Limited's emphasis on the fact that the Lake Shore Funds are located outside the U.S. is misplaced. The correct focus is on Lake Shore Limited and what it did in its capacity as a CFTC-registered CTA and CPO with respect to the

Finally, even Lake Shore Limited's counsel admitted that his client was a CTA, stating in his opening statement that the evidence would show that "[t]o the extent Lake Shore Limited had a role in the activity that will be discussed in this hearing, it was a trading adviser making trading decisions." (Tr. 15:18-20). This concession is amply supported by the only believable evidence in the record regarding the CTA issue. *See Specialized Seating, Inc. v. Greenwich Industries, L.P.*, 472 F.Supp.2d 999, 1006 (N.D. Ill. 2007) (recognizing that counsel had conceded a fact during his opening statement).<sup>8</sup>

Thus, Lake Shore Limited must allow inspection of its books and records relating to the Lake Shore Alternative Financial Asset Funds in their entirety as of the date of its CFTC registration. In the interests of staving off future disputes, the court clarifies this statement by noting that this means *all* of its books and records kept in connection with its activities as a CTA and CPO for the Lake Shore Alternative Financial Asset Funds, not just the records relating to Fund IV – U.S. and the single U.S. investor. *See* 7 U.S.C. § 6n; 17 C.F.R. §§ 1.31 (inspection); 4.22 (CPO records); 4.33 (CTA records).

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funds, not the funds' physical location or place of incorporation.

<sup>8</sup> In this regard, the court again notes that Lake Shore Limited's position that all relevant activities occurred outside the U.S. and that it did not engage in any activities in the U.S. that were essential to the completion of the alleged misrepresentations is incorrect, given the court's finding that Lake Shore Limited acted as a CFTC-registered trading advisor and pool operator, the uncontroverted evidence that a portion of the funds' trading occurred on U.S. exchanges, and counsel's acknowledgment that his client acted as a trading advisor. Lake Shore Limited appears to want to have it both ways: when it believes that it is helpful to its cause to characterize itself as a trading advisor, it does so. However, when that position is contrary to its desired result, it reverses course and states that its only activity in the U.S. involves a single U.S. investor who invested in a U.S. feeder fund. The court feels constrained to note that this type of shift in position (which is illustrative of Lake Shore Limited's litigation strategy to date as opposed to an isolated incident) makes it difficult to rely on any factual representations made by counsel. The court does not make this comment lightly, and hopes that counsel takes it to heart.

The court also notes that Lake Shore Limited's proffered authority to the contrary is inapposite. Lake Shore Limited directs the court's attention to *New York Currency Research Corporation v. CFTC*, characterizing it as holding that "foreign currency records need not be produced because they were outside the firm's CTA and CPO registrations." Lake Shore Limited's Proposed Findings of Fact & Conclusions of Law at 20. This is a mischaracterization of the *New York Currency* case. In that case, the petitioner was an off-exchange foreign currency trader who was also a registered CTA and CPO for the relevant time period. *New York Currency Research Corporation v. CFTC*, 180 F.3d at 86. The Second Circuit found that the CFTC failed to produce any evidence indicating that the petitioner ever acted in the capacity as a CTA or CPO and its registration by itself was not enough to trigger record keeping obligations under 17 C.F.R. §§ 4.23 or 4.33. *Id.* at 91. The Second Circuit then considered whether the petitioner had an obligation, independent of its registration as a CTA and CPO, to maintain records, and concluded that the failure to show that the petitioner acted as a CTA and CPO meant that it was not subject to 17 C.F.R. §§ 4.23 or 4.33. *Id.* at 92.

The *New York Currency* opinion thus actually supports the proposition that registration plus activity as a CTA and/or CPO triggers the record keeping obligations in 17 C.F.R. §§ 4.23 or 4.33. The court is not requiring Lake Shore Limited to produce records of all of its activities, whether or not those activities involved CTA or CPO activity. *See New York Currency Research Corporation v. CFTC*, 180 F.3d at 91. Instead, it is requiring Lake Shore Limited to produce records kept in its capacity as the CTA and CPO for the Lake Shore Alternative Financial Asset Funds. The fact that some of these records may relate to foreign transactions does not shield them from production since Lake Shore Limited's obligation to keep and produce its records

arose from its actions as the CTA and CPO for the Lake Shore Alternative Financial Asset Funds. *See id.*

At the risk of being repetitive, the court reiterates that the fact that the Lake Shore Alternative Financial Asset Funds themselves and the vast majority of the investors are outside the U.S. is irrelevant. Lake Shore Limited's record keeping obligations flow from its activities as a CTA and CPO under the Act. The court is not ordering the funds themselves or the investors to do anything. Instead, its order is exclusively directed at Lake Shore Limited. If Lake Shore Limited did not want to subject itself to the jurisdiction of the CFTC and this court, it should not have registered with the CFTC as a CTA and CPO, provided advice and management wearing the hat of a CFTC-registered CTA which led to trading on U.S. exchanges, and operated the Lake Shore Alternative Financial Asset Funds and solicited investors wearing the hat of a CFTC registered CPO. Having done so for all of the Lake Shore Alternative Financial Asset Funds, however, its obligation to keep and produce records is not limited to the single U.S. investor or Fund IV–U.S.

## **2. The SMA Records**

This brings the court to Lake Shore Funds I, II, III, and IV. Lake Shore I and II consist in part of SMAs. The court has virtually no information about the SMAs, so it cannot ascertain whether the related records are subject to production under the reasoning set forth in the preceding section. Given the prior history relating to document production and Lake Shore Limited's willingness to adopt what can only be characterized as extremely aggressive and cabined interpretations of its obligations, the court declines to blindly accept Lake Shore Limited's statement that the SMA records are not subject to production. If Lake Shore Limited

does not produce the records, the CFTC and the court have no way of knowing if Lake Shore Limited's position regarding non-production of these records is well-founded and the interests of justice cannot be served.

There is only one solution: someone other than Lake Shore Limited must review the records to determine if Lake Shore Limited's contention that they relate exclusively to non-U.S. investors trading outside the U.S. on non-U.S. exchanges with no connection to Lake Shore Limited or Lake Shore Inc. in their capacities as CTAs or CPOs is correct. Since relying on Lake Shore Limited's assertions with no means of review is off the table, the court suggests that a viable solution would be to allow CFTC counsel to review the records with an attorneys' eyes only designation at Lake Shore Limited's offices. If Lake Shore Limited is not agreeable, appointing a special master at Lake Shore Limited's expense is another possibility. *See Fed. R. Civ. P. 53; Trans Union, LLC v. Credit Research, Inc.*, No. 00 C 3885, 2003 WL 1338131, at \*2 (N.D. Ill. Mar. 11, 2003) (where the court was "painfully aware of the complexities" arising from analysis of data and the issues were "sufficiently complicated to require the aid of an auditor," case was exceptional and warranted use of a special master). The court is open to all reasonable suggestions, and encourages the parties to meet and confer prior to filing a joint memorandum by September 4, 2007, regarding this issue. If this is not possible, they may file separate memoranda.

**3. Records of Lake Shore Inc. and Lake Shore Group Prior to Lake Shore Limited's Registration as a CPO and CTA**

As discussed above, Lake Shore Limited is a mere continuation of Lake Shore Inc., which was registered CTA and CPO until its registrations were withdrawn in February of 2007, and

Lake Shore Inc. was part of the Lake Shore Group. According to the fact sheets for all of the Lake Shore Alternative Financial Asset Funds, Lake Shore funds were trading as of January of 1994 (Lake Shore Alternative Financial Asset Fund I and Lake Shore Alternative Financial Asset Fund Yen Fund, which both had the new 5% risk model introduced in 2003), January of 2005 (Lake Shore Alternative Financial Asset Fund II and Lake Shore Alternative Financial Asset Fund Yen Fund Class II), May of 2006 (Lake Shore Alternative Financial Asset Fund III and Lake Shore Alternative Financial Asset Fund Yen Fund Class III), February of 2007 (Lake Shore Alternative Financial Asset Fund IV), and May of 2006 (Lake Shore Alternative Financial Asset Fund IV Class E). (Plt. Ex. 19).

Clearly, someone was acting as the CPO and CTA for all of these funds from 1994 to Lake Shore Limited's taking over of those responsibilities in January of 2007. But, was Lake Shore Inc. the CTA and CPO? Mr. Church was a principal for an entity called Lake Shore Inc., and stated that this entity was formed in 1996. He testified via declaration that Mr. Baker approached him in 2000 or 2001 with a business concept (soliciting firms and securities brokers to interest them in getting clients to invest in commodity futures) using the Lake Shore Inc. name. According to Mr. Church, he was not interested because he thought the concept was not compliant with U.S. law, but he eventually agreed to sell the Lake Shore Inc. name to Mr. Baker in 2006.

If the court credits Mr. Church's testimony, the Lake Shore Inc. entity associated with Mr. Church's CTA and CPO registrations was not affiliated with the Lake Shore Group. This is consistent with the fact that the name Lake Shore Inc. (as used by the Lake Shore Group) was actually the firm name for Lake Shore Alternative Investment, which was 100% owned by Senior

Management of Lake Shore Asset Management, whose management overlaps with that of Lake Shore Limited. Moreover, the Pitch as well as the fund fact sheets show that Lake Shore was using the Lake Shore Inc. name and Lake Shore's proprietary trading model at least as early as 2003, and that Lake Shore (apparently, as the Lake Shore Group's Lake Shore Inc., as opposed to Mr. Church's Lake Shore Inc.) had been trading prior to that date.

The reader will recall that the Lake Shore Group is a common enterprise containing (at least at one time), among other entities, an entity holding itself out as Lake Shore Inc. In addition, Lake Shore Limited is a mere continuation of the Lake Shore Group's Lake Shore Inc. (as opposed to Mr. Church's Lake Shore Inc., to the extent that the court credits his testimony). Lake Shore Limited is also part of the Lake Shore Group common enterprise. Mr. Brodersen acknowledged that Lake Shore Limited became registered to do business in the United States on January 17, 2007, and thus is not expected to possess records prior to this date.

This means that Lake Shore Limited is not expected to possess records prior to January 17, 2007, *in its capacity as Lake Shore Limited*. In contrast, it would be expected to possess records in its previous incarnation as Lake Shore Inc., as part of the Lake Shore Group common enterprise, and as the acting CTA and CPO for the Lake Shore funds. It thus must allow inspection of any CTA and CPO records predating January 17, 2007, to the extent that those records are subject to production as discussed in the preceding section.<sup>9</sup>

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<sup>9</sup> Lake Shore Limited appears to be claiming that it began to act as the CPO and CTA for the Lake Shore Funds in January of 2007 as a tabula rasa with no idea who the prior CTA and CPO were. The court finds that this position is untenable, so discovery should provide additional confirmation as to the identity of the prior CTA and CPO.

In conclusion, the court notes that document production is not an elaborate game of hide the ball. This is not a criminal case where the CFTC is required to prove its claims with proof beyond a reasonable doubt while Lake Shore Limited stands by and withholds all of its records. As set forth above, Lake Shore Limited is required to maintain certain documents as a CPO and CTA in connection with its CTA and CPO activities, and must allow inspection of those documents. In the event that Lake Shore Limited believes that certain documents are outside the scope of this order, retention of documents at Lake Shore Limited's discretion and with no means of verifying the veracity of Lake Shore Limited's position is unacceptable. As with the SMA records, the documents must be reviewed by someone other than Lake Shore Limited. Thus, the parties are directed to include a discussion of this issue in the memorandum addressing the SMA records issue if necessary.

**E. Financial Analysis/Fraud**

**1. The Act**

Under the Act, the CFTC may establish futures fraud by showing that a defendant made material misrepresentations or omissions. 7 U.S.C. §§ 6b(a)(2)(I), (ii), (iii) & 6o(1)(A), (B); *see also Slusser v. CFTC*, 210 F.3d 783 (7th Cir. 2000); *Com'n v. Rosenberg*, 85 F. Supp.2d 424, 447 (D.N.J. 2000). Material misrepresentations or omissions may consist of a variety of acts. For instance, misrepresentations about experience, historical success, and profitability are material and may constitute fraud. *See Com'n v. White Pine Trust Corp.*, No. 04CV2093 J(NLS), 2007 WL 1121249, at \*9 (S.D. Cal. Apr. 11, 2007) ("Misrepresentations regarding the experience or profitability of a firm or account manager are material because historical success and experience would be considered extremely important factors to a reasonable investor when

deciding to invest”); *Com’n v. Valko*, No. 06-60001-CIV, 2006 WL 2582970, at \*4 n.1 (S.D. Fla. Aug. 16, 2006) (false reports of profitability with respect to commodity futures trading accounts constitute a violation of 7 U.S.C § 6b(a)(2)(ii)); *Com’n v. Noble Wealth Data Info. Serv., Inc.*, 90 F. Supp.2d 676, 686 (D.Md. 2000) (defendant’s profit claims constituted false reports and fraud within the meaning of the Act), *aff’d in part, vacated in part, sub nom. Com’n v. Baragosh*, 278 F.3d 391 (4th Cir. 2002); *Com’n ex rel. Kelley v. Skorupskas*, 605 F. Supp. 923, 932-33 (E.D. Mich. 1985) (defendants violated § 4b(a) and § 4o(1) of the Act by issuing false monthly statements to customers).

## **2. Amount Under Management and Purported Profitability**

Prior to addressing the CFTC’s concerns about Lake Shore Limited’s representations regarding the amount under management and its profitability, the court will provide a recap of the structure of the Lake Shore Funds.

### **I. Structure of the Funds**

It is said that a picture is worth a thousand words, so the reader is invited to refer back to the court’s summary chart attached as exhibit 1 hereto as an aid in understanding Lake Shore’s structure and assets, and the conclusions to be drawn therefrom. In general, the parties and witnesses refer to Lake Shore Funds I, II, III, and IV without specifying whether they mean Lake Shore Funds I, II, III, and IV or Lake Shore Alternative Financial Asset Funds I, II, III, and IV. As shown by the chart, however, they are not substantively interchangeable.

Specifically, Lake Shore I and II are comprised of SMAs and funds, while Lake Shore III and IV are comprised exclusively of funds. The funds that form or are part of Lake Shore Funds I, II, III, and IV are Lake Shore Alternative Financial Asset Fund I (which includes the Lake

Shore Alternative Financial Asset Yen Fund), as well as Lake Shore Alternative Financial Asset Funds II, III, and IV. Lake Shore Alternative Asset Accounts I and II are part of the SMAs that in turn are part of Lake Shore I and II.

The court has accepted Mr. Baker and Mr. Rosenthal's statements, which are supported by numerous Lake Shore documents, that the only FCMs for any Lake Shore Funds (*i.e.*, Lake Shore Alternative Financial Asset Funds I, II, III, and IV) are Fimat, Lehman, Man, and Sentinel. Fimat, Lehman, and Man have all of the Lake Shore Alternative Financial Asset Funds' trading accounts.<sup>10</sup> All four of the FCMs turned the Lake Shore records in their possession over to the CFTC and/or the NFA. With this in mind, the court turns to the amount under management, Lake Shore Limited's profitability, questionable transfers between accounts, and Lake Shore Limited's access to funds.

**ii. Amount Under Management – Lake Shore Funds**

Based on evidence currently before the court, the amounts in Lake Shore Funds I, II, III, and IV add up to \$1.05B (to the extent that the figures provided by Lake Shore Limited are accurate). This explains why the amounts in Lake Shore Alternative Financial Asset Funds I, II, III, and IV – which are only part of Lake Shore Funds I, II, III, and IV – do not add up to \$1.05B. Thus, the court rejects the CFTC's claim that the fact that the amounts in Lake Shore Alternative Financial Asset Fund Funds I, II, III, and IV do not add up to \$1.05B is a misrepresentation.<sup>11</sup>

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<sup>10</sup> The court also rejects Lake Shore Limited's suggestion that the Lake Shore Funds also were trading using accounts in the name of FTG, because Mr. Brodersen testified that if this was allowed, it would have to have been disclosed, and no such disclosures were made.

<sup>11</sup> This conclusion is based on the evidence presently before the court, as the CFTC referred to the Lake Shore Funds and the Lake Shore Alternative Financial Asset Funds interchangeably in its submissions. The court thus has not confronted the potential issue of

To verify the \$1.05B figure, which is the total amount under management for the Lake Shore Funds I, II, III, and IV, auditors would need to verify the amounts in the SMAs. Lake Shore Limited has refused to turn over its records, and the accounts for the SMAs are not with the four FCMs who have given their records to the CFTC/NFA.<sup>12</sup> The lack of information about the SMAs means that it is impossible to add up the amount under management to ascertain if Lake Shore Limited's claim that the Lake Shore Funds manage a total of \$1.05B is correct. This issue will have to wait for another day.

**iii. Amount Under Management and Profitability – Lake Shore Alternative Financial Asset Funds**

The court's ability to assess the amount under management and purported profitability for the Lake Shore Alternative Financial Asset Funds does not suffer from this defect (*i.e.*, lack of information about the SMAs) because the FCMs with Lake Shore trading accounts produced their records to the CFTC, and those records are for the Lake Shore Alternative Financial Asset Funds. More specifically, the Lake Shore Alternative Financial Asset Funds' track records confirm if they were profitable, and marketing materials from the various Lake Shore entities made representations about the alleged profitability of the Lake Shore Alternative Financial Asset Funds, *not* the Lake Shore Funds. This is a critical fact, as the reader will recall that Lake Shore Funds I and II consist of SMAs plus Lake Shore Alternative Financial Asset Funds I and II, while Lake Shore Funds III and IV consist only of Lake Shore Alternative Financial Asset

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whether Lake Shore Limited misrepresented the amount under management in the Lake Shore Alternative Financial Asst Funds by making it appear that those funds were actually the Lake Shore Funds, which purportedly have much more money in them.

<sup>12</sup> More specifically, the record contains evidence relating to one account for Lake Shore Alternative Asset Account II at Sentinel, which is part of the SMA portion of Lake Shore II.

Funds III and IV. The reader will also recall that Lake Shore Limited was the CTA and CPO for the Lake Shore Alternative Financial Asset Funds.

Thus, the results touted by the Lake Shore entities are for the Lake Shore Alternative Financial Asset Funds, which use Lake Shore Limited as their CTA and/or CPO and are either traded via FCMs Fimat, Man, and Lehman, or invested with FCM Sentinel. All four of these FCMs provided records to the CFTC and/or the NFA. This means that the lack of evidence about the SMAs is irrelevant, because those accounts do not affect the trading performance of the Lake Shore Alternative Financial Asset Funds, which is reflected in its entirety in the FCM records which the CFTC's witnesses analyzed.<sup>13</sup>

When Mr. Brodersen eliminated double counting of assets which had occurred based on his initial review of the information gained from screenshots from Lake Shore Limited's computers, he obtained a 2007 total as of the date of his calculations for the Lake Shore Alternative Financial Asset Funds in an amount between \$275M and \$288M as of June 11, 2007. Lake Shore Limited's marketing materials (attached to Plt. Ex. 15) generally corroborate that amount, as Lake Shore Limited represented that the total in the Lake Shore Alternative Financial Asset Funds as of June 2007 adds up to \$293M.

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<sup>13</sup> Lake Shore Limited vigorously argues that its account naming conventions (featuring account names on its website that did not consistently match the names of the accounts at the FCMs and accounts that did not consistently have corresponding trading accounts with matching names) mean that Mr. Brodersen's analysis of the Lake Shore accounts is untrustworthy. It must be noted, however, that Lake Shore Limited refused to explain its account naming conventions to the NFA. Moreover, Mr. Brodersen testified that Lake Shore Limited's highly unusual account naming system did not impact his ability to identify accounts or track the performance of those accounts. He did, however, state that in his 21 years of auditing commodity pools, he had never encountered the kind of naming conventions like those used by Lake Shore Limited.

During the July 2, 2007, conference call between the CFTC/NFA and Lake Shore Limited, Mr. Baker indicated that approximately \$230M was invested in the Lake Shore Alternative Financial Asset Funds. It thus appears that there is an unexplained discrepancy of close to \$60 million between June 11, 2007 and July 2, 2007.

Despite the time disparity, the court is extremely troubled by this significant drop in the total amount in all of the Lake Shore Alternative Financial Asset Funds. The drop is shown by evidence in the record, while Lake Shore Limited did not introduce any concrete evidence that would explain it. Instead, it attempted to explain the difference via cross-examination by blaming fund of fund transfers, noting that the FCM records were not all from the same date, pointing to differences in the exchange rate, and positing, with no evidentiary support whatsoever that despite overwhelming evidence to the contrary, Lake Shore Limited and Lake Shore Inc. could have used additional FCMs which would make Mr. Brodersen's calculations unreliable.

- Transfers Between Funds – Mr. Brodersen testified that even if funds were being transferred between the various funds, the overall amount would all even out in the end. In other words, if Fund X transferred \$20M to Fund Y, it would net out because Fund X would be \$20M in the red and Fund Y would be \$20M in the black. It cannot be stressed strongly enough that the CFTC and NFA have FCM records for all of the Lake Shore Alternative Financial Asset Funds. Thus, even if monies were being transferred between the various funds, it should net out. Thus, Mr. Brodersen concluded that even without information about all possible fund of fund transfers, overall profitability was the critical inquiry. He then noted that the Lake Shore Alternative Financial Asset Funds had lost money overall, despite Lake Shore's representation that all of the Lake Shore Alternative Financial Asset Funds were profitable.
- Differences in Dates – Mr. Brodersen used FCM records from May, June, and July of 2007. It is possible that Lake Shore Limited suffered significant losses in this period, and merely suffering losses, no matter how large, does not show fraud. However, as of 2003, Lake Shore Group instituted a risk management overlay consisting of a systemwide 5% monthly drawdown limit with no discretion. Lake Shore Limited uses this same proprietary model, and its due diligence represents

that it will have a maximum monthly drawdown of 5%, and that this strategy has been successful for more than 39 months.

Lake Shore Group's May of 2007 fact sheets for Lake Shore Alternative Financial Funds I, II, III, and IV have monthly returns listed which are consistent with this alleged overlay. With \$230M invested in the Lake Shore Alternative Financial Asset Funds, the maximum loss for three months using the mandatory 5% overlay represented by Lake Shore Limited cannot explain all of the missing \$60M. Thus, while there are no guarantees in life, particularly in the highly volatile world of futures trading, the existence of the non-discretionary 5% monthly drawdown limit represented in the Lake Shore Limited documents is inconsistent with the numbers Mr. Brodersen calculated.

- Similarly, Mr. Brodersen's audit of the FCM records reflects that Lake Shore Alternative Financial Asset Fund II showed monthly trading losses of greater than 5%/month for four of nine months between October 2006 and June of 2007 (-5.45% , -17.03%, -9.71%, and -20.20%). Similarly, Lake Shore Alternative Financial Asset Fund I shows trading losses for March through May of 2007 that are substantially higher than 5% (-39.08%, -21.19%, and -70.87%). While trading losses by themselves do not show fraud, the losses are inconsistent with representations made by Lake Shore Limited about the mandatory risk overlay.
- Exchange Rate – Lake Shore Limited has presented no evidence as to changes in the exchange rate to support its position that these changes are the root, at least in part, for the discrepancies. It also has not explained how unspecified changes in the exchange rate could lead to such a dramatic shift.
- Mystery FCMs – Mr. Baker, Mr. Rosenthal, and the vast majority of Lake Shore Limited and Lake Shore Group's records state that all of the Lake Shore Alternative Financial Funds use Fimat, Sentinel, Man, and Lehman as FCMs. Lake Shore Limited has not provided any evidence indicating that there in fact were any other FCMs. Moreover, Mr. Brodersen testified that even if Mr. Baker was doing business in Europe under the name FTG, if any of the Lake Shore Funds invested in an account in the name of FTG, if it was allowed, it would have to have been disclosed. The record does not show that this ever happened. Similarly, no evidence shows that Lake Shore Group traded in Europe under a different name such as FTG, or had trading accounts in FTG's name. Lake Shore Limited's counsels' speculation that Lake Shore Group traded under another name and had additional trading accounts under that name is not evidence. In contrast, the CFTC has pointed to ample evidence indicating that Lake Shore Group and Lake Shore Limited only used the four FCMs specified by Mr. Baker and Mr. Rosenthal.

Fundamentally, Lake Shore Limited's position boils down to its contention that the CFTC and NFA lack the necessary documents to audit its trading history. As discussed above, once the Lake Shore Funds (two of which include SMAs) are distinguished from the Lake Shore Alternative Financial Asset Funds (which do not include SMAs), this position is unfounded. In any event, Lake Shore Limited's missing records argument is unpersuasive because it cannot use its own decision not to produce records as both a sword and a shield. Just as the court cannot infer that Lake Shore Limited's documents contain damaging evidence, it is not required to infer that they contain exonerating evidence.

Similarly, the fact that the CFTC witnesses stated that it would be possible for their analysis to change if Lake Shore Limited produced its records does not persuade the court to accept Lake Shore Limited's invitation to jettison their testimony. The fact that it is possible for the analysis to change does not shed any light on how probable such a change might be. The record shows that the probability of such a change occurring is at best *de minimis* due to Mr. Brodersen's testimony that the regulators were particularly interested in reviewing trading records prepared by third parties (*i.e.*, the FCMs) because of the reliability of obtaining information from an outside source. In other words, reviewing Lake Shore Limited's records will provide a fuller picture of its activities, but the absence of its records does not somehow make the FCM records unreliable.

In sum, after balancing the CFTC's evidence against Lake Shore Limited's cross-examination of the CFTC witnesses, the court concludes that Lake Shore Limited's attacks on the CFTC's witnesses are either unmerited or unpersuasive. Lake Shore Limited's refusal to produce its records, the CFTC's decision to obtain FCM records on different dates, and shifts in the

exchange rate means that the CFTC and NFA auditors were unable to come up with 100% ironclad calculations down to the penny. Nevertheless, the millions of dollars worth of discrepancies in Lake Shore Limited's claimed and actual profits for the Lake Shore Alternative Financial Asset Funds is compelling.

**iv. Transfers Between Funds**

The fact sheet for Lake Shore Alternative Financial Asset Fund IV states that the manager's investment objective "is to maximize returns whilst preserving capital" by investing equally in Lake Shore Fund I, II, and III. (Plt. Ex. 19 at 221 04 0157). In other words, money from Lake Shore Alternative Financial Asset Fund IV should flow towards Lake Shore Alternative Financial Asset Funds I, II, and III.

This is inconsistent with Ms. Johnson's testimony about seven transfers totaling \$2,107,532.96 that were made between Lake Shore Limited's various Sentinel accounts in June of 2006. Based on her review of the documents, Ms. Johnson concluded that monies were being transferred from Lake Shore Alternative Financial Asset I, II, and III to IV (obviously, this is the opposite direction from that represented in Lake Shore Limited's fact sheet for Fund IV, which said that Fund IV flowed to Funds I, II, and III). She opined that this suggested that Lake Shore did not treat Fund IV—Trading as independent from the other accounts. She then stated that it was possible that the transfers were legitimate, but that Lake Shore Limited had offered no evidence explaining why the transfers were made.

Mr. Brodersen testified about these same transactions and stated that they appeared to be irregular since an FCM cannot commingle the funds of one commodity pool with another. He conceded that it would be possible for the transfers to be proper because they could be fund to

fund transfers, represent a feeder fund, or flow from an investor's decision to change strategy, but stated that this type of activity would warrant further investigation. Again, Lake Shore Limited presented no evidence as to why the transfers occurred. These transfers are thus notable in that Ms. Spear believed they were questionable and Mr. Brodersen opined that they warranted an audit.

**v. Access to Funds**

Lake Shore Limited contends that it could not have engaged in fraud because it does not handle customer assets, hold fund accounts in its name, or have the ability to withdraw money from funds. It legally cannot do any of these things, because clients invest in a specific fund pursuant to that fund's offering documents, and these monies are deposited with a FCM in accounts which are owned by that fund and are in that fund's name.<sup>14</sup> Moreover, the CFTC has not asserted that Lake Shore Limited committed fraud by improperly accessing monies in any funds' accounts, largely because, for the reasons above, it cannot do so directly. Thus, Lake Shore Limited's arguments about its inability to directly access any of the Lake Shore Funds are irrelevant.

**vi. Disclosures Regarding Interest on the Sentinel Accounts**

Lake Shore Limited is the reorganized version of Lake Shore Inc., which represented that "Lake Shore operates on a full disclosure basis." (Plt. Ex. 8, p.5, 299 02 0011). Lake Shore Limited did not disclose that between 2006 and 2007, it transferred approximately \$1.4M

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<sup>14</sup> The same cannot be said for Lake Shore Limited's principals, who were authorized to transfer monies from the accounts. For example, the principals and employees of Lake Shore Limited were authorized to transfer funds in all of Lake Shore's accounts at Sentinel from at least June 28, 2001.

(\$976,207 + \$445,683) of the interest from the Sentinel accounts to Anglo to use for Lake Shore Limited's payroll. It also did not disclose that pool funds were being used to pay its overhead and expenses.

The offering memorandum for Fund IV disclosed that interest would not be paid to the investors on funds held with the custodian. Mr. Brodersen testified that telling investors that they would not receive interest on funds held with the custodian does not absolve Lake Shore Limited from an obligation to disclose any conflicts of interest, such as the fact that a pool is paying interest earned on customer funds to the CPO for its operating, personnel, and overhead expenses. It is possible to disclose the type of financial arrangements made by Lake Shore Limited, which would make them permissible. However, Lake Shore Limited did not do so. This is problematic because according to Mr. Brodersen, this information must be disclosed. Indeed, Mr. Brodersen testified that if he learned during an audit that a pool operator was using a substantial amount of customer funds to pay for undisclosed expenses, the NFA would take emergency action against that pool operator.

Turning to the interest transferred to Hanford, Sentinel records show that between November of 2002 and June 2007, about \$9,936,505.74 in earned interest was wired out from Lake Shore accounts at Sentinel to Hanford for the benefit of Philip Baker. In addition, on June 4, 2007, Hanford sent \$710,993.50 to Lefkada, Athens, Greece, for the purchase of real estate. No evidence shows that investors were ever told that interest on Fund accounts would be given to a company run by a Lake Shore Limited principal to be used for the purchase of real estate.

Again, payment of interest to an entity affiliated with the Lake Shore's principal is proper if it is authorized and disclosed, but Lake Shore Group and Lake Shore Limited's disclosure

documents do not state that the interest would be paid to Hanford. In response to the CFTC's arguments about disclosure, Lake Shore Limited contends that it disclosed that Lake Shore Alternative Financial Asset Funds I, II, and III would not transfer any interest on cash balances held by the Bank of New York to Lake Shore Alternative Financial Asset Fund IV Limited. The court finds that this disclosure is ineffective because it accepts Mr. Brodersen's testimony that this disclosure cannot be fairly understood as a statement that income earned on the funds on deposit at Sentinel would be paid to an undisclosed entity controlled by Baker.

Overall, Lake Shore Limited's failure to make the required disclosures is troubling. Perhaps, as Lake Shore Limited suggests, investors would have acted the same if Lake Shore Limited had made the required disclosures. And perhaps, as Lake Shore Limited also suggests, these transfers were proper because Mr. Baker was acting in his capacity as a principal of Hanford and Anglo, as opposed to a more nefarious reason, when he arranged for the transfers. These suggestions, however, are just that. The record shows that the transfers were a conflict of interest that had to be disclosed, and they were not disclosed.

#### **vii. The U.S. Investor**

Mr. Stoltz, who appears to be the sole U.S. investor, deposited \$1M in May of 2007 with Fund IV–U.S., which is a feeder fund for Lake Shore Alternative Financial Asset Fund IV. As of June 11, 2007, Lake Shore records showed that Mr. Stoltz had a balance of \$1,015,324.29. The court infers from Lake Shore Limited's promotional materials that it regularly notified investors regarding their accounts. This would mean that Mr. Stoltz received information about his account's status.

Lake Shore Limited's June 11, 2007 figure for Mr. Stoltz would show any profit he made in May and June. Mr. Brodersen reviewed the Lehman, Fimat, and Sentinel records for Fund IV, which are dated June 30, 2007, May 31, 2007, and July 26, 2007, respectively. In May of 2007, Fund IV had a negative performance. Due to the date of the FCM records, Mr. Brodersen was unable to verify the performance of Lake Shore Alternative Financial Asset Fund IV in its entirety from June 1 through June 11, 2007. Based on the partial records (*e.g.*, the fact that Fimat's records are dated May 31, 2007), it is theoretically possible, although not supported by any evidence in the record, that the Lake Shore Limited's claimed June 11, 2007 balance for Mr. Stoltz was correct. For this to be so, Fimat's records for June 1 – 11, when added to the existing Man and Lehman records for this time period, would have to show that the June 11 figure was accurate.

The timing of the Fimat records thus appears to be problematic because without June records from Fimat, there is no way to verify Lake Shore Limited's numbers. Of course, however, this is not true: Lake Shore Limited has records that would fill the gap. It has taken the position that it was only obligated to turn over records for Mr. Stoltz and Fund IV–U.S., and it allegedly turned over these records. Yet, Lake Shore Limited did not point to any evidence indicating that its hypothetical supporting the accuracy of Mr. Stoltz's June 11 balance is accurate. This is telling because even under Lake Shore Limited's own theory that it was only obligated to produce records for Mr. Stoltz and Lake Shore Fund IV/Lake Shore Alternative Financial Asset Fund IV (which the court believes is unjustifiably limited), it should have been able to support the June 11 balance.

This leaves the court with the fact that once again, Lake Shore Limited's position regarding the accuracy of the June 11 balance is unsupported by any evidence. In contrast, Mr. Brodersen believed that the June 11 figure was questionable due to Fund IV's May performance and the June records from two of the three FCMs.

**viii. Churning**

The alleged churning in the two Man accounts took place in 2004, well before Lake Shore Limited's formation in 2006. The court has found that Lake Shore Limited is both the mere continuation of Lake Shore Inc. and a participant in the Lake Shore common enterprise, which was responsible for the unusual commission to equity ratio in the two Man accounts. Nevertheless, this activity is sufficiently far off in time that it is not probative as to whether Lake Shore Limited is currently engaging in churning. Moreover, the record does not contain any other evidence indicating that this is an ongoing practice. This is significant as the CFTC obtained records from all of Lake Shore's FCMs, who would be in a position to detect any other instances of alleged churning. Thus, the suspicious commission to equity ratio in 2004, while less than ideal, is not particularly helpful to the court's consideration of Lake Shore Limited's current situation.

**ix. Lake Shore Limited's Response to the CFTC's Evidence**

The court next considers Lake Shore Limited's position on a more global level. Lake Shore Limited contends that the court cannot infer that Lake Shore Limited's failure to produce its records means that those records contain information supporting the CFTC's position. The cases it cites in support deal with the inferences to be drawn from the destruction of documents and the presumptions attaching to failure to comply with document retention regulations. *See*

*Park v. City of Chicago*, 297 F.3d 606, 615 (7th Cir. 2002); *Rummery v. Ill. Bell Tel. Co.*, 250 F.3d 553, 558-59 (7th Cir. 2001). The court sincerely hopes that neither of these situations has occurred in this case.

The effect of Lake Shore Limited's failure to produce its documents is more basic: without these documents, Lake Shore Limited was largely reduced to presenting its side of the story by cross-examining the CFTC's witnesses, which is what happened during the preliminary injunction hearing. For example, Lake Shore Limited asked Mr. Brodersen if the irregularities in Lake Shore Limited's stated profitability could be explained by fund of fund transfers but did not present any evidence supporting this theory. This was repeated throughout the hearing as time after time, Lake Shore Limited asked witnesses if an alternative interpretation was possible, but presented absolutely no evidence in support of its proposed interpretation.

Lake Shore Limited has also taken the position that its promotional materials are irrelevant because the CFTC did not present a witness who said that Lake Shore Limited actually used these materials. Given that Mr. Sainsbury (a former Lake Shore Limited salesperson) made statements about the importance to customers about certain portions of the Pitch, Mr. Eveleigh produced the Pitch, organizational charts, and various offering memoranda of the Lake Shore funds to the CFTC, and other Lake Shore Limited documents were produced to the CFTC by third parties such as the Bank of Montreal-Ireland, the court finds this argument unpersuasive. In any event, Lake Shore Limited has pointed to no evidence supporting its contention that it never used any of its documents when it was acting as a CTA and CPO for the funds.

Positing theories unsupported by any evidence is not enough to controvert the CFTC's positions where those positions are amply supported by credible evidence. *Murphy v. ITT*

*Educational Services, Inc.*, 176 F.3d 934, 938 (7th Cir. 1999) (“speculations do not provide an evidentiary foundation to support any of [the plaintiff’s] claims or her attempt to draw any favorable, reasonable inferences from that evidence”); *Clearwater Transport, Inc. v. N.L.R.B.*, 133 F.3d 1004, 1012 (7th Cir. 1998) (speculation, conjecture, and hypotheticals are not enough to support a party’s position regarding key facts); *Commodity Futures Trading Com’n v. IBS, Inc.*, 113 F.Supp.2d 830, 853 (W.D.N.C. 2000) (rejecting testimony that withdrawals represented payment for services where no records or tax forms were produced to support this assertion). This is especially true when the vast majority of the financial evidence came in through CFTC and NFA auditors, who were extremely believable as well as disinterested witnesses, and there is no evidence supporting an inference that the Lake Shore Limited documents in the record are somehow untrustworthy.

Thus, Lake Shore Limited is attempting to swim upstream when it responds to credible and compelling evidence from the CFTC with speculative theories. This is especially true given that the court has devoted a very significant amount of time to mulling over the evidence in this case, and is simply not persuaded that Lake Shore Limited’s theories are well-founded in light of the record as a whole. In sum, the fact that Lake Shore Limited’s theories do not provide any concrete basis for discrediting the evidence in the record, coupled with the nature of the CFTC’s evidence and the gravity and extent of the issues shown by the record, supports the court’s conclusion that the CFTC has demonstrated that it has a likelihood of success on the merits of its claims against Lake Shore Limited.

**F. Harm to Investors and Lake Shore Limited**

The court next considers the harm that would be caused by granting the requested relief. Based on the evidence before the court, Lake Shore Limited was the Lake Shore Alternative Financial Asset Funds' CTA and CPO and made material misrepresentations and omissions about (among other things) the performance of its trading system and the profitability of the Lake Shore Alternative Financial Asset Funds. The court believes that based on the present record, there is a substantial risk of harm to investors' financial interests if Lake Shore Limited is allowed to continue its present course of action.

The court is also not persuaded that the lack of evidence about investors' satisfaction or dissatisfaction with Lake Shore Limited is particularly meaningful. Investors are certainly free to invest as they wish, with the entity of their choice. No evidence, however, shows that the investors are aware of the CFTC's fraud allegations or the evidence presented during the preliminary injunction hearing.<sup>15</sup> Moreover, even if Lake Shore Limited's investors are an exceptionally risk-seeking group who would not be concerned if they knew about the evidence adduced during the preliminary injunction hearing (a proposition that the court simply cannot accept), Lake Shore Limited must still comply with the Act's record keeping and anti-fraud provisions.

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<sup>15</sup> The court excluded declarations from intermediaries, dealers, and clients voicing their desire to see the asset freeze lifted because those documents reflected the declarants' belief that the declarant and/or his/her organization were being harmed by the now-vacated statutory restraining order and that Lake Shore Limited's document production issues were not enough to warrant an asset freeze. Lake Shore Limited has produced no evidence indicating that any of its intermediaries, dealers, or clients are aware of the CFTC's allegations of fraud and still wish to allow Lake Shore Limited to continue to act as the CTA and CPO for the Lake Shore Alternative Financial Asset Funds.

Ultimately, the court is charged with determining if the CFTC has made a prima facie showing that Lake Shore Limited violated the Act and if there is a reasonable likelihood of future violations. *See Commodity Futures Trading Com'n v. Hunt*, 591 F.2d at 1220. Past misconduct is highly suggestive of the likelihood of future misconduct. *Id.* Here, the serious and ongoing nature of Lake Shore Limited's past actions, the totality of the circumstances, and Lake Shore Limited and its principals' positions with respect to the Lake Shore Alternative Financial Asset Funds are all exceedingly troubling. Any harm to Lake Shore Limited incurred as a result of this order is due to its own conduct and does not outweigh the need to protect the investors. Accordingly, for all of the reasons discussed above, the court finds that the CFTC has met its burden of showing a likelihood of success on the merits and that the balance of harms weighs in favor of entering a preliminary injunction.

## **F. Scope of Appropriate Relief Based on the Present Record**

### **1. Asset Freeze**

Lake Shore Limited contends that an asset freeze is improper based on its belief, which the court has rejected, that the CFTC failed to meet its burden of showing a prima facie case of fraud. Injunctive relief may include an asset freeze if necessary to protect investors. *Commodity Futures Trading Com'n v. Lake Shore Asset Management Ltd.*, 2007 WL 2206862, at \*3; *Commodity Futures Trading Com'n ex rel. Kelley v. Skorupskas*, 605 F.Supp. 923, 943 (D.C. Mich. 1985) (asset freeze was necessary "to protect the investors from further fraud, to deter such conduct in the future, and to prevent [the defendant] from benefitting any further from her deceit"). An asset freeze may also be warranted if it is necessary to ensure the availability of permanent relief later. *Commodity Futures Trading Com'n v. Kimberlynn Creek Ranch, Inc.*, 276

F.3d 187, 193 (4th Cir. 2002); *Levi Strauss & Co. v. Sunrise Int'l Trading Inc.*, 51 F.3d 982, 987 (11th Cir. 1995) (“A request for equitable relief invokes the district court’s inherent equitable powers to order preliminary relief, including an asset freeze, in order to assure the availability of permanent relief”); *Commodity Futures Trading Com’n v. American Metals Exchange Corp.*, 991 F.2d 71, 77 (3d Cir. 1993) (an asset freeze is “designed to preserve the status quo by preventing the dissipation and diversion of assets”). The court finds that due to the substantial risk of investor harm shown by the present record, an asset freeze is necessary not only to protect investors but also to prevent the potential dissipation of monies in the accounts.

It is, however, important to note that any asset freeze entered by this court overlaps with the existing asset freeze covering all NFA members with Lake Shore Limited accounts that was issued by the NFA. The NFA asset freeze is the subject of a pending administrative appeal by Lake Shore Limited. *See Lake Shore Asset Management, Ltd. v. National Futures Association*, CFTC Docket No. CRAA 07-02. The parties are directed to promptly advise the court of any rulings in that administrative proceeding. Nevertheless, because the court finds that the CFTC has met its burden of proof, an asset freeze to protect the investors is warranted, even if that freeze is duplicative of the NFA asset freeze.

The court next considers the reach of the asset freeze. The Act allows for the entry of a restraining order against “any person” necessary to prevent the disposal of assets obtained in violation of the Act. 7 U.S.C. § 13a-1. The CFTC’s brief focuses on freezing the assets at the FCMs, but its proposed order has a far broader reach because the CFTC seeks an order requiring the foreign FCMs to transfer Lake Shore assets to their affiliates. The CFTC has presented no authority in support of this request so it is denied without prejudice.

The court also takes judicial notice of Sentinel's recent legal troubles. *See SEC v. Sentinel Management Group, Inc.*, 07 C 4684 (N.D. Ill.); *Farr Financial, Inc. v. Sentinel Management Group, Inc.*, 07 C 4614 (N.D. Ill.); *In re: Sentinel Management Group, Inc.*, 07-14987 (N.D. Ill. Bankr.). Currently, an asset freeze imposed by the NFA pursuant to a Member Responsibility Action is in place and is directed at the four FCMs in this case (Sentinel, Man, Lehman, and Fimat). If the NFA was to lift its separate asset freeze, it may best serve the interests of the investors to move the funds at Sentinel to another FCM if possible, where they can remain frozen pending resolution of this case. Certainly, to the extent that monies at Sentinel become available, it is not in the investors' best interests to place them at the end of the line of creditors. The court will leave it to Lake Shore Limited to file a motion addressing this contingency if warranted.

## **2. Scope of Document Production**

The CFTC seeks an order requiring Lake Shore Limited to allow the CFTC to access all records of foreign financial institutions that hold Lake Shore assets. This request is overly broad because at this point, the CFTC has only established that Lake Shore Limited (as well as Lake Shore Inc. and the other entities in the Lake Shore common enterprise) engaged in activities in the capacity of a CPO and/or CTA that were material to the successful completion of the alleged scheme vis-a-vis the four FCMs. Lake Shore clearly must have additional documents relating to the SMAs. At this time, however, the court is not convinced that requiring Lake Shore Limited to produce these documents to the CFTC is appropriate.<sup>16</sup> As discussed above, the court would

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<sup>16</sup> This means that the CFTC's request for an accounting, which is directed at all records of Lake Shore Limited and the Lake Shore enterprise, is overly broad as it reaches records other than those relating to the Lake Shore Alternative Financial Asset Funds.

like to consider the parties' views as to the appropriate way to proceed (special master, attorneys' eyes only review, or some other means which allows review of Lake Shore Limited's reasoning in deciding certain documents are not subject to production). Thus, the parties shall meet and confer and file a joint memorandum by September 4, 2007, regarding this issue. If this is not possible, they may file separate memoranda.

The CFTC also has asked the court to order Lake Shore Limited to sign a records release that appears to cover foreign financial institutions. As discussed at length above, Lake Shore Limited must produce certain of its own documents as well as the corresponding documents of its predecessors because the CFTC has established that Lake Shore Limited acted as a CTA and CPO in connection with the Lake Shore Alternative Financial Asset Funds and Lake Shore Limited is the mere continuation of Lake Shore Inc., a participant in the Lake Shore common enterprise. This is not the same thing as requiring the Lake Shore Funds or the Lake Shore Alternative Financial Asset Funds to produce their records. Because the CFTC has not established the propriety of requiring funds to produce their records, its request to obtain these documents is denied without prejudice.

### **III. Conclusion**

For the reasons set forth above, the CFTC's motion for a preliminary injunction is [#65] is granted in part and denied in part. The parties shall meet and confer and file a joint memorandum by September 4, 2007, regarding the appropriate way to handle documents that Lake Shore Limited believes are outside the scope of this order. If this is not possible, they may file separate memoranda. Lake Shore Limited is also directed to promptly advise the court of any substantive rulings in the NFA administrative proceeding.

In addition, IT IS HEREBY ORDERED THAT:

1. Defendant Lake Shore Limited, individually and as part of the Lake Shore common enterprise, is restrained, enjoined and prohibited, until further order of the court, from directly or indirectly:
  - A. Cheating, defrauding or willfully deceiving or attempting to cheat, defraud or willfully deceive other persons in or in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of, any commodity futures transactions, in violation of Sections 4b(a)(2)(I) and (iii) of the Act, 7 U.S.C. § 6b(a)(2)(I) and (iii);
  - B. Willfully making or causing to be made to any other person any false report or statement thereof or causing to be made for any person any false record thereof, in or in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of, any commodity futures transactions, in violation of Section 4b(a)(2)(ii) of the Act, 7 U.S.C. § 6b(a)(2)(ii);
  - C. While acting in the capacity of a commodity pool operator (“CPO”) or commodity trading advisor (“CTA”) employing any device, scheme or artifice to defraud any client or participant or prospective client or participant or engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant by use of the mails or any means or instrumentality of interstate commerce, in violation of Section 4o(1) of the Act, 7 U.S.C. § 6o(1).
  - D. In its capacity as a registered CTA or CPO, failing to provide upon request of the Commission the name and address of each client, subscriber, or participant, or to submit samples or copies of all reports, letters, circulars, memoranda, publications, writings, or other literature distributed to clients, subscribers or participants or prospective clients, subscribers or participants or other records required by Commission Regulation, in violation of Section 4n of the Act, 7 U.S.C. § 6n and Regulations 1.31, 4.23 and 4.33, 17 C.F.R. §§ 1.31, 4.23, 4.33 (2007).

2. Defendant Lake Shore Limited, individually and as part of the Lake Shore common enterprise, is further restrained, enjoined and prohibited, until further order of the court, from directly or indirectly:

- A. Engaging in, controlling, or directing the trading of any commodity futures and options accounts, on their own behalf or on behalf of any other person or entity, whether by power of attorney or otherwise;
- B. Soliciting customers to trade commodity futures and options;
- C. Trading on or subject to the rules of any registered entity as that term is defined in § 1a(29) of the Act, 7 U.S.C. § 1a(29);
- D. Placing orders, giving advice or price quotations or other information in connection with the purchase or sale of commodity futures and options contracts for themselves and others; and
- E. Otherwise engaging in any business activities related to commodity futures and options trading.

3. Defendant Lake Shore Limited, individually and as part of the Lake Shore common enterprise, and the Lake Shore common enterprise are further restrained, enjoined and prohibited, until further order of the court, from directly or indirectly:

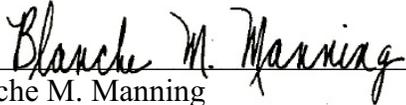
- A. Destroying, mutilating, concealing, altering or disposing of any books and records, documents, correspondence, brochures, manuals, electronically stored data, tape records or other property of Lake Shore Limited or the Lake Shore common enterprise, wherever located, including all such records concerning the Lake Shore common enterprise's business operations;
- B. Refusing to permit authorized representatives of the CFTC to inspect and copy, when and as requested by those representatives, any books and records, documents, correspondence, brochures, manuals, electronically stored data, tape records or other property of Lake Shore Limited, the Lake Shore common enterprise, and their agents, wherever located and whether they are in the hands of any Lake Shore entity, to the extent that those records related to activities of any Lake Shore entity taken as a CTA or CPO or that relate to trading that occurred on U.S. exchanges; and

- C. Withdrawing, transferring, removing, dissipating, concealing or disposing of, in any manner, any assets related to Lake Shore Alternative Financial Asset Funds I, II, III, and IV, including but not limited to, all funds, money or securities held in safes, safety deposit boxes and all funds on deposit in any financial institution, bank or savings and loan accounts held by, under the control of, or in the name of Lake Shore Alternative Financial Asset Funds I, II, III, and IV.

4. The injunctive provisions of this order shall be binding on Lake Shore Limited and the Lake Shore common enterprise and any person insofar as he or she is acting in the capacity of officer, agent, servant, employee or attorney of Lake Shore Limited or the Lake Shore common enterprise and any person who receives actual notice of this order by personal service, facsimile or otherwise insofar as he or she is acting in active concert or participation with Lake Shore Limited or the Lake Shore common enterprise.

5. This Order shall remain in effect until further order of the court.

DATE: August 28, 2007

  
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Blanche M. Manning  
United States District Judge

Court's Summary Chart  
Exhibit 1 to CFTC v. Lake Shore Limited, 07 3598, (N.D. Ill. Aug 28, 2007)

This summary chart is drawn directly from the exhibits and depicts the organization of the Funds at the FCM level. Specifically, it is a combination of and drawn from Plaintiff. Ex. 15 (Mr. Brodersen's declaration and the accompanying exhibits), Plaintiff. Ex 4 at p.3 (the Pitch). Finally, in the interests of simplicity, the court omitted the details for the many Yen funds.

