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**IN THE UNITED STATES DISTRICT COURT**
**FOR THE DISTRICT OF NEW JERSEY**

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|---|---|---|
| COMMODITY FUTURES TRADING COMMISSION, | ) | |
| Plaintiff, | ) | No.: 04-cv-1512 (RBK) |
| vs. | ) | |
| EQUITY FINANCIAL GROUP, LLC, TECH TRADERS, INC., TECH TRADERS, LTD., MAGNUM INVESTMENTS, LTD., MAGNUM CAPITAL INVESTMENTS, LTD., VINCENT J. FIRTH, ROBERT W. SHIMER, COYT E. MURRAY, and J. VERNON ABERNETHY, | ) | Hearing Date: February 2, 2007 |
| Defendants. | ) | |

**MEMORANDUM IN SUPPORT OF MOTION OF EQUITY RECEIVER TO APPROVE SETTLEMENT WITH PUTTMAN & TEAGUE, LLP, ELAINE TEAGUE, AND JOHN PUTTMAN**

Stephen T. Bobo (the "**Receiver**"), the Equity Receiver of Defendant Equity Financial Group, LLC ("**Equity**"), the managing member of Shasta Capital Associates, LLC ("**Shasta**"), submits this memorandum in support of his motion for entry of an Order approving a settlement agreement with Puttman & Teague, LLP, Elaine Teague and John Puttman (collectively, "**TEAGUE**") and permanently enjoining and barring members of Shasta and certain defendants

**EXHIBIT B**

from commencing or continuing claims against TEAGUE that arise out of or relate to the accounting services TEAGUE provided to Equity, for itself and on behalf of Shasta from July 2001 through April 1, 2004.

**A. The Receiver's Investigation of Claims Against TEAGUE**

1. This Court appointed the Receiver as part of the initial restraining order entered on April 1, 2004. According to the provisions of that order, the responsibilities of the Receiver include "marshalling, preserving, accounting for and liquidating assets" of the Defendants and initiating or becoming party to "any actions or proceedings ... necessary to preserve or increase the assets of the Defendants."

2. From approximately July 2001 through the present, Defendant Equity has been the manager of Shasta, which pooled funds invested by its members for trading in commodity futures contracts through Tech Traders, Inc.

3. From approximately July 2001 through April 1, 2004, Equity, for itself and on behalf of Shasta, retained TEAGUE to provide accounting services, including providing certain agreed upon procedures in connection with the verification of Tech Traders, Inc.'s ("**Tech Traders**") monthly performance results and providing the results in monthly "reports" on Puttman & Teague, LLP letterhead sent to Equity and others.

4. Pursuant to authority from this Court, the Receiver has investigated the quality of TEAGUE's services and the impact of those services on Equity, for itself and on behalf of Shasta. This investigation has included review of statements, correspondence and supporting documentation, participating in the depositions of Elaine Teague, Robert W. Shimer ("**Shimer**"), Vincent J. Firth ("**Firth**"), and Jack Vernon Abernethy ("**Abernethy**"), interviews with various investors, and reviewing applicable professional standards. As a result of this investigation, the

Receiver has determined that Equity, for itself and on behalf of Shasta, may have meritorious claims against TEAGUE arising out of the accounting services described in paragraph 3 above. TEAGUE denies that any such claims exist.

**B. The Receiver's Preliminary Conclusions Regarding Potential Damages of Shasta**

5. As set forth in the Affidavit of Stephen T. Bobo In Support Of Motion Of Equity Receiver For Entry Of Order Approving Settlement With Puttman & Teague, LLP, Elaine Teague, and John Puttman ("Bobo Affidavit"), the Receiver and his attorneys and accountants have spent considerable time investigating the investment activities of the Defendants, including attempting to estimate the aggregate loss that will be ultimately suffered by Shasta and its members. These efforts have included obtaining and reviewing the paper and electronic records of Equity, Shasta, Tech Traders, the Magnum entities, Shimer and Firth. The Receiver's accountants have reviewed and summarized the records of nearly 50 banks and trading accounts used by the Defendants in their investment activities. The Receiver has interviewed numerous investors, as well as Defendants Shimer, Coyt E. Murray ("**Murray**") and Abernethy.

6. Shasta was organized in mid-2001 and began accepting funds from its members at the beginning of 2002 to place with Tech Traders for trading commodities. Shasta took in approximately $14.6 million from outside members. By April 1, 2004, it had transferred $13.9 million to Tech Traders for commodity trading. Shasta did not place any funds received from its investors in any other investments. Shasta had a total of approximately 65 outside members as of April 1, 2004. From funds received from Tech Traders, Shasta disbursed $1.5 million back to certain of its investors.

7. Tech Traders regularly reported substantial trading profits to its investors. Shasta in turn reported the supposed profit amounts to its members.

8. Of the approximately $43.1 million that investors placed with Tech Traders between April 12, 2001 and April 1, 2004, Tech Traders returned a net amount of approximately $11.3 million[1] to investors. Approximately $17.5 million previously held by brokerage firms and banks in Tech Traders' name was frozen by this Court's restraining orders. Another $870,000 was frozen in Shasta's bank account, although $497,000 of that amount was received after the freeze order and has been returned to investors.

9. The Receiver can only estimate the damages suffered by Shasta and its members at this time. The damages amount is inversely related to the amount of the total distributions to be made, which can only be estimated for several reasons. First, the Receiver only recently received approval of a claim process for non-investor creditors of Tech Traders and Equity and cannot predict the total amount of allowable creditor claims. Second, the Receiver has not made a final determination regarding possible meritorious claims against other former professionals and other third parties. Third, the costs of fully administering the receivership are unknowable at this point.

10. Taking all these uncertainties into account, however, the Receiver estimates that Shasta will ultimately be able to return to its members somewhere in the range of 50 percent of their investments, including prior distributions. In the aggregate, the damages of Shasta and its members thus will likely be in the range of one-half of the difference between $14.6 million and $1.5 million, or about $6.5 million.

**C. The TEAGUE Settlement**

11. After first entering into a tolling agreement to alleviate statute of limitations concerns, the Receiver engaged in lengthy negotiations with TEAGUE in an attempt to resolve

[1] Although Tech Traders repaid investors approximately $12 million, over $600,000 of the $12 million represents fictitious profits and not returns of principal.

the claims without the need for litigation. That negotiation process included a one-day mediation conducted by the Honorable Kenneth Gillis (Ret.), an experienced former judge of the Circuit Court of Cook County, Illinois. The negotiations resulted in TEAGUE agreeing to pay a settlement amount of $700,000, subject to certain terms and conditions as discussed below. A true and correct copy of the parties' settlement agreement is attached to the Bobo Affidavit as Exhibit 1.

12. Among the information the Receiver considered in negotiating a settlement was TEAGUE's ability to satisfy a significant judgment. For the period in question, TEAGUE has professional malpractice insurance coverage with a claim limit of $1 million. The Receiver also reviewed financial statements for the TEAGUE firm and its two principals and is satisfied that their assets are likely not substantial enough to justify the expenses of collection. The Receiver therefore attributed little additional net value to a recovery from those other sources, after considering the costs of collection efforts.

13. The Receiver also considered the magnitude and scope of TEAGUE's role on behalf of Shasta, the potential defenses raised by TEAGUE during the negotiations and the risks of litigation. Although the Receiver believes the merits of the claims to be strong, achieving a better result through litigation is not assured. Another important consideration was that the costs of discovery and trial would be significant, including the costs of engaging an expert witness in the area of accountant malpractice. The Receiver believes that the total costs of litigating the claim to verdict would be well in excess of $100,000 and that recovery of those costs and attorneys' fees through the litigation would be unlikely. If an appeal were taken, this would result in additional fees and expenses for the receivership estate. A final significant factor considered by the Receiver was the effect of the settlement on the progress of the receivership as

a whole. Litigation against TEAGUE would cause the receivership to stay open for at least a year, or perhaps significantly longer depending on the Court's docket, whether an appeal were taken, and the degree of difficulty in enforcing the judgment. This additional period of delay unless the claim was settled was another significant motivation to resolve the matter through settlement.

14. The Receiver believes that the settlement amount of $700,000 is fair and reasonable under the circumstances. Those circumstances include the $1 million limit of TEAGUE's insurance coverage, the limited other resources available for recovery, the inherent risks and certain costs of litigating the claims against TEAGUE, and the need to expedite the administration of the receivership estate. The settlement amount also is well within a reasonable range of TEAGUE's proportional share of comparative liability for the range of damages suffered by Shasta and its members. As an additional confirming measure of the reasonableness of the settlement amount, Judge Gillis recommended this amount to the parties as an appropriate settlement during the mediation.

15. As a condition of settlement, TEAGUE has required the entry of an order permanently barring and enjoining Shasta members as well as Defendants Firth, Shimer, Abernethy, Murray and Tech Traders from commencing or continuing any individual claims against TEAGUE that arise out of or relate to the conduct described above in paragraph 3 (the "Bar Order"). This Bar Order would also apply to those persons' heirs, trustees, executors, administrators, legal representatives, agents, successors and assigns with notice or actual knowledge of the TEAGUE settlement or the Bar Order.

16. The proposed settlement agreement attached hereto also includes the following additional terms required by TEAGUE to provide appropriate assurances of finality:

a. the Receiver agrees not to execute on a money judgment he obtains against a third party not subject to the Bar Order to the extent of the amount of any money judgment that such third party obtains against TEAGUE in that same case;

b. the Receiver covenants not to sue TEAGUE on any related claims;

c. the Receiver will limit recoveries on claims against third parties not subject to the Bar Order who may have rights against TEAGUE to that defendant's proportionate share of liability and the fault of others for whom the defendant may be liable, but specifically excluding any share of liability that would be attributable to TEAGUE;

d. the Receiver agrees that after the effective date of the TEAGUE settlement, any settlements he enters into with third parties not subject to the Bar Order on claims relating to the allegations he asserted against TEAGUE shall include a general release by the settling party in favor of TEAGUE, and TEAGUE shall execute a reciprocal release in favor of such settling party; and

e. the terms of the settlement shall be kept confidential except as required to seek Court approval of the settlement, including notice of the terms to the Shasta investors and other parties in interest, and as thereafter required to respond to legal process.

**D. Entry of the Bar Order is Broadly Supported by Federal Law and Public Policy**

17. Entry of the Bar Order required by the proposed settlement is well within this Court's authority and discretion. Federal Rule of Civil Procedure 16 grants the Court authority to use special procedures, including bar orders, to assist parties in reaching a settlement. Fed. R. Civ. P. 16(c)(9); *see In re Munford, Inc.*, 97 F.3d 449, 455 (11th Cir. 1996). Federal common

law also authorizes entry of a bar order. *Franklin v. Kaypro Corp.*, 884 F.2d 1222, 1228-32 (9th Cir. 1989). In addition, a district court supervising an equity receivership has "extremely broad" inherent equity power to fashion effective relief. *SEC v. Handy,* 803 F.2d 1034, 1307 (9th Cir. 1986); *S.E.C. v. Wenke,* 622 F.2d 1363, 1369 (9th Cir. 1980). This equity power is at least as broad as the power of a bankruptcy court to enter an appropriate bar order. *Munford,* 97 F.3d at 455 (relying on Section 105(a) of the Bankruptcy Code and Fed. R. Civ. P. 16 to affirm bankruptcy court's entry of bar order).

18. Additionally, bar orders may play a critical role in facilitating settlement by allowing settling parties to limit the risks of settlement. *See Munford*, 97 F.3d at 455. Bar orders assure settling parties that they will be protected against claims of third parties related to the underlying litigation. The Court must determine whether the proposed Bar Order is fair and equitable. Among the factors courts consider in making such a determination are the interrelatedness of the claims that the bar order would preclude, the likelihood of third parties to prevail on the barred claim, the complexity of the litigation and the likelihood that the settlement would deplete the resources of the settling parties. *Id.* (relying on *U.S. Oil & Gas*, 967 F.2d at 493-96).

19. Public policy also strongly favors pretrial settlement. Depending on the complexity of the case, it can "occupy a court's docket for years on end, depleting the resources of parties and the taxpayers while rendering meaningful relief increasingly elusive." *Id.* (quoting *U.S. Oil & Gas v. Wolfson*, 967 F.2d 489, 493 (11th Cir. 1992) (internal quotations omitted)); *see also* Fed. R. Civ. P. 16, Advisory Comm. Notes ("Since it obviously eases crowded court dockets and results in savings to the litigants and the judicial system, settlement should be facilitated at as early a stage of the litigation as possible.").

20. In similar instances, courts have entered bar orders to facilitate the settlement of disputes. For example, in *SEC v. Capital Consultants, LLC*, the court granted the equity receiver's motion for approval of a settlement agreement (which contained a bar order) between the Receiver and certain defendants. No. Civ. 00-1290-KI, 2002 WL 31470399, at *3 (D. Or. Mar. 8, 2002). In that case, the settling defendants agreed to pay $500,000 to the receiver on behalf of all claimants in exchange for the claimants' release of all claims against the defendants. *Id.* at *1. The court approved the settlement as "fair and equitable to the [claimants] and...in the best interest of the receivership estate." *Id.* at *2.

21. Similarly, in *Neuberger v. Shapiro*, the court approved a settlement agreement among a plaintiff class, a co-plaintiff committee of unsecured creditors, and one of the defendants, an accounting firm. 110 F. Supp. 2d 373, 386-88 (E.D. Pa. 2000). The agreement contained a bar order that permanently enjoined "all parties to the Litigation" from bringing any claim against the accounting firm that involved the conduct alleged in the plaintiffs' complaint. *Id.* at 381. The court considered a number of factors before approving the class settlement, including the risks of establishing both liability and damages and the reasonableness of the settlement.[2] *Id.* at 378-80. Ultimately, the court concluded that the parties' settlement, which included the bar order, was "fair, reasonable and just and...in the best interests of the settlement class." *Id.* at 386. *Cf. In re Devon Capital Mgmt., Inc.*, 261 B.R. 619, 625-26 (W.D. Pa. 2001) (striking proposed bar order as overly broad because it prohibited "any and all persons," including those who were neither parties to settlement agreement nor beneficiaries of the settlement proceeds, from asserting claims against defendants). *See generally Eichenholtz v.*

[2] The court looked at "nine fairness factors" to be considered in approving all class action settlements. *See id.* Although some of these factors are specific to the class action context, most of the factors translate to other cases, such as the instant matter, where the settlement at issue will impact a large group of individuals.

*Brennan*, 52 F.3d 478 (3rd Cir. 1995) (approving the use of bar orders against non-settling defendants).

22. The requested order barring claims against TEAGUE is consistent with and permissible under both the All Writs Act, 28 U.S.C. § 1651, and the Anti-Injunction Act, 28 U.S.C. § 2283. The All Writs Act provides federal courts with the power to "issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law." 28 U.S.C. § 1651(a). Here, the proposed Bar Order applies not only to certain Defendants but also to approximately 70 Shasta investors. Although these Shasta investors are not technically parties to this case, they are parties in interest and virtually all have submitted claims to the Receiver. Accordingly, enjoining these investors from bringing related claims against TEAGUE is consistent with the All Writs Act.

23. As one federal appeals court has noted:

> An important feature of the All-Writs Act is *its grant of authority to enjoin and bind non-parties to an action when needed to preserve the court's ability to reach or enforce its decision in a case* over which it has proper jurisdiction. . . . The power to bind non-parties distinguishes injunctions issued under the Act from injunctions issued in situations in which the activities of the third parties do not interfere with the very conduct of the proceeding before the court.

*In re Baldwin-United Corp.*, 770 F.2d 328, 338 (2nd Cir. 1985) (emphasis added) (internal citation omitted); *see also United States v. New York Tel. Co.*, 434 U.S. 159, 174 (1977) (finding that the power conferred by the All Writs Act extends to nonparties "who are in a position to frustrate the implementation of a court order or the proper administration of justice. . .").

24. The *Baldwin* court held that the requirements of the All Writs Act are satisfied "if the parties whose conduct is enjoined have actual notice of the injunction and an opportunity to seek relief from the district court." *Baldwin*, 770 F.2d at 340.

25. The principles espoused by the *Baldwin* court are applicable here. The requested injunctive relief is necessary "to prevent third parties from thwarting the court's ability to reach and resolve the merits of the federal suit before it." *Id.* at 338-39. The Receiver will provide notice of the requested Bar Order to all parties whose conduct is to be enjoined. In addition, all Shasta investors are already before this Court on matters relating to claims they filed in the receivership – with the exception of a handful of investors who had been repaid in full before this case began.

26. A federal court's broad authority under the All Writs Act may be limited by the Anti-Injunction Act, which prevents the court from granting an injunction to stay a state court proceeding unless "expressly authorized by Act of Congress, *or where necessary in act of its jurisdiction, or to protect or effectuate its judgments.*" 28 U.S.C. § 2283 (emphasis added); *see also Baldwin*, 770 F.2d at 335. The Anti-Injunction Act, however, would only apply where a state court action had already been initiated. Here, the Receiver is unaware of any existing state court actions involving claims against TEAGUE that arise out of or relate to the conduct described above in paragraph 3. Accordingly, the Anti-Injunction Act would not now apply.

27. Even if an investor were to file a state court action at a later date, the Anti-Injunction Act would allow the Court to enjoin such an action in certain circumstances. One such circumstance exists where an injunction is necessary to protect or effectuate the Court's judgments. 28 U.S.C. § 2283; *see also Flanagan v. Arnaiz*, 143 F.3d 540, 545 (9th Cir. 1998) (federal injunction staying state court proceeding proper where district court expressly retained jurisdiction to construe and enforce settlement agreement); *Gross v. Barnett Banks, Inc.*, 934 F. Supp. 1340, 1345-46 (D. Fla. 1995) (district court issued injunction to prevent state court from interfering with settlement in federal class action involving substantially similar claims and to

protect district court's judgment). Similarly, this Court is requested to retain jurisdiction to construe and ensure the effectiveness of the TEAGUE settlement agreement.

28. An injunction is also permissible where it is necessary in aid of the district court's jurisdiction. 28 U.S.C. 2283; *see also Flanagan*, 143 F.3d at 545-46. This clearly extends to the Court's jurisdiction over the assets of this receivership estate and the ability to maximize these assets for the benefit of investors and other parties in interest.

29. The Bar Order sought by the Receiver is necessary to protect and effectuate this Court's judgment, and is likewise necessary in aid of this Court's jurisdiction. As a result, the requested relief would be consistent with the Anti-Injunction Act even if that statute were applicable.

**E. The Bar Order Will Not Prejudice Shasta Members**

30. The requested Bar Order against Shasta members asserting related claims meets the fair and equitable standards. Based on the course of the settlement negotiations, the Receiver believes that this requirement is fair to Shasta and its members because such a favorable level of settlement value would not be available to Shasta in the absence of such a Bar Order. Therefore, Shasta investors will receive a higher recovery will be available as the result of being barred from asserting related individual claims. The investor claims to be barred would only be those arising from the same conduct as the claim being settled, and the settlement proceeds will be received for the benefit of those investors. Thus, there is a high degree of interrelatedness with the claims to be barred.

31. It is unclear at best whether the Shasta investors possess and could prevail on individual claims against TEAGUE. They would likely have to overcome issues of standing, privity and statute of limitations. In addition, many Shasta members signed agreements which,

according to TEAGUE, provide a contractual defense against claims by those members. TEAGUE's proportional share of comparative liability could also be asserted to attempt to limit or preclude additional investor recovery. On the other hand, all of the Shasta members who are still owed funds have filed claims in this proceeding, and they will likely obtain a higher distribution amount through these settlement terms than without the Bar Order provision. This factor also favors entry of the proposed Bar Order.

32. The individual barred claims would likely have the same relatively high degree of complexity as the accounting malpractice claim being settled. This factor likewise favors the Bar Order.

33. This proposed settlement would also deplete 70 percent of the available insurance coverage, leaving a maximum of only $300,000 in coverage that could be reached by any other claimant. From his review of TEAGUE's financial information, the Receiver has concluded that TEAGUE's non-insurance assets would likely yield marginal additional value, after considering collection costs. Although the settlement would exhaust most of the insurance value available, it would not entirely deplete it. Not obtaining all of the value available does not preclude entry of the Bar Order, however. *See Munford*, 97 F.3d at 456 (settlement of $350,000 and bar order approved where insurance coverage was $400,000). On balance, the Receiver believes that TEAGUE is contributing a substantial enough portion of the available insurance coverage as to make any possible individual investor claims against TEAGUE economically unattractive. This level of settlement would not be available to Shasta in the absence of the Bar Order. Therefore, the Receiver believes that, on balance, this factor also favors entry of the Bar Order.

34. The Receiver is unaware that any Shasta member has either commenced a lawsuit against TEAGUE or has retained counsel to review the factual background and potential

individual claims against TEAGUE. In addition, the Receiver has discussed the proposed settlement terms and proposed claims bar with approximately six Shasta investors. All indicated agreement with the settlement concept and expressed no objection to being barred from bringing individual claims.

35. Although the Receiver believes that Shasta members will accept the proposed settlement terms and will not object to being barred from asserting related individual claims against TEAGUE in return for receiving the monetary benefits of the settlement, those members are entitled to the opportunity to review and comment on the terms, including the proposed Bar Order.

36. Accordingly, the Receiver mailed to a notice to Shasta members regarding this motion, the settlement terms and background, the proposed Bar Order, and how to respond to the motion should they choose to do so. The form of notice provided to the Shasta members is attached to the Bobo Affidavit as Exhibit 2.

**E. The Court Should Exercise Continued Jurisdiction Over the Settlement Agreement**

37. The settlement agreement with TEAGUE contains certain detailed terms that the parties negotiated at length. In recognition of the complexity and importance of those provisions to the overall settlement, and the significance of the settlement payment to Shasta and its investors, as well as the possibility of disagreements over the interpretation and compliance with the various terms, the Receiver and TEAGUE have conditioned their agreement on this Court retaining continuing and exclusive jurisdiction over the Settlement Agreement and the order.

38. Federal courts have recognized provisions for retention of jurisdiction as appropriate and enforceable as long as the District Court's judgment incorporates the settlement agreement and the District Court expressly consents to such continuing jurisdiction. *Kokkonen v.*

*Guardian Life Insurance Co.*, 511 U.S. 375, 381-82 (1994); *Flanagan*, 143 F.3d at 547. Accordingly, the Court is requested to retain such exclusive, continuing jurisdiction here.

39. The Receiver has discussed the proposed settlement provisions with the attorney for the CFTC, and she indicated that the CFTC had no objection to the settlement or this motion.

40. After the Court has considered the merits of the settlement and any objections thereto, the Receiver requests that the Court approve the settlement with TEAGUE as fair and equitable and enter the proposed order approving the attached settlement agreement, authorizing implementation of its terms, and permanently enjoining and barring Shasta members and the specified defendants from commencing or continuing claims against TEAGUE that arise out of or relate to the conduct described above in paragraph 3.

DATED: December 27, 2006

Respectfully submitted,

STEPHEN T. BOBO
Equity Receiver

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