

**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

_____)	
In re:)	Chapter 7
)	
)	Case No. 12-27488
PEREGRINE FINANCIAL GROUP, INC.,)	
)	Hon. Judge Carol A. Doyle
)	
Debtor.)	Hearing Date: September 12, 2012
_____)	Hearing Time: 10:00 a.m.

**RESPONSE / STATEMENT OF THE COMMODITY FUTURES TRADING
COMMISSION REGARDING THE TRUSTEE’S MOTION FOR AN ORDER
APPROVING TRANSFERS AND INTERIM DISTRIBUTIONS TO CERTAIN
COMMODITY CUSTOMERS OF THE DEBTOR**

Comes now, the United States Commodity Futures Trading Commission (“CFTC”), by and through undersigned counsel, and offers this Statement Regarding the Chapter 7 Trustee’s Motion for an Order Approving (I) Transfers and Interim Distributions to Certain Commodity customers of the Debtor, and (II) Procedures for Soliciting Offers from Futures Commission Merchants to Receive such Transfers on Account of Commodity Customers (Dkt. 147) (“the Distribution Motion”). As set forth more fully below, the CFTC is in favor of distributing money to the Debtor’s customers as soon as is reasonable and practicable.

Because this case involves allegations of fraudulent books and records of the Debtor’s estate, however, the CFTC believes that distributions should be made only after reasonable due diligence to ensure that the data underlying the distribution are reliable. The CFTC has consulted with the Trustee and his proposed Professionals about the methodology for performing validity tests of the Debtor’s commodity customer accounts.

On August 28, CFTC staff discussed recommended validity tests for the “First Wave Accounts.” Staff explained that many of the suggested tests could be performed by generating reports on the accounting software at the Debtor’s offices and analyzing the results, and that such testing would greatly reduce the possibility that money will be distributed inaccurately.

Based on the information available, it appears that none of those tests was completed before the Trustee filed the Distribution Motion. Nor has the Trustee explained to this Court what set of validation tests he has completed, nor the results of such tests, to support his conclusion that a distribution based solely on the books and records of the Debtor should be authorized at this time.

Rather, over the course of the weekend of September 7-9, 2012, the Trustee communicated to CFTC staff information concerning the steps he intends to complete in the future. Some of these steps are estimated to be completed over the course of the next two weeks, while for others, the estimated completion date is unknown, apparently because the plan of work depends on the results of other steps.

For the reasons discussed below, the CFTC believes that it would be prudent for the Trustee to complete validity testing – and, in parallel, work on the implementation of the mechanics of the distribution – before this Court authorizes the distribution.

BACKGROUND

The CFTC, its Federal Case Against the Debtor, and its Role in this Bankruptcy

The CFTC is a federal governmental agency created by Congress to regulate accounts, agreements, and transactions involving swaps or contracts of sale of a commodity for future delivery.¹ Upon revelation of the alleged frauds committed at the Debtor, the CFTC filed a civil

¹ The CFTC has exclusive jurisdiction with respect to accounts, agreements, and transactions involving swaps or contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to

lawsuit against the Debtor and its founder, Russell Wasendorf, Sr., under Section 6c of the Commodity Exchange Act, as amended, 7 U.S.C. § 13a-1. *See United States Commodity Futures Trading Comm'n v. Peregrine Financial Group, Inc., et al.*, No. 1:12-cv-05383 (N.D. Ill.). The same day, the Debtor filed the bankruptcy petition in this case.

The CFTC's Regulations apply to this bankruptcy. *See* 7 C.F.R. Part 190. Moreover, because the Debtor was a commodity broker, the CFTC has standing to appear and be heard in this case. *See* 11 U.S.C. § 762(b).

This case arose as a result of alleged fraud perpetrated using the books and records of the Debtor, and specifically involving unauthorized use of customer accounts. The CFTC, during its preliminary investigation, discovered over \$45 million in fictitious bookkeeping entries and unusual activity/balances in customer accounts. Over the course of several weeks, the CFTC consulted with the Trustee and his Professionals about methods for "validity testing" customer accounts in the Debtor's books and records to ensure that customer distributions are not based on fictitious information.

STATEMENT

The Trustee Should Report Upon Tests of the Validity of The Debtor's Books and Records.

The CFTC believes that, before the Court authorizes the Distribution to the First Wave Accounts, the Trustee should report to the Court (1) what validity tests his professionals have completed with respect to the relevant customer accounts, (2) the results of those tests, and (3) the analysis supporting his conclusion that such testing was sufficient to reasonably assure a

section 5 of the CEA or a swap execution facility, or any other board of trade, exchange, or market. 7 U.S.C. § 2(a)(1)(A). *See* The Commodity Exchange Act, as amended by the Food, Conservation, and Energy Act of 2008, Pub. L. No. 110-246, Title XIII (the CFTC Reauthorization Act of 2008 ("CRA")), §§ 13101-13204, 122 Stat. 1651 (enacted June 18, 2008) and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203 ("Dodd-Frank Act"), Title VII (the Wall Street Transparency and Accountability Act of 2010), §§701-774, 124 Stat. 1376 (enacted July 16, 2010).

proper distribution. The report should be filed at least three business days before the hearing at which authorization of such distribution is considered.

This procedure need not significantly delay the proposed distribution date for the First Wave Accounts. Depending on the Trustee's estimate of when the relevant work might be completed, and the Court's availability, such a hearing might be scheduled for September 27th, or during the week of October 1.

Moreover, the Trustee should, in parallel, continue his work to finalize the mechanics of the distribution, so that once the proper recipients are identified and the amounts are computed, and the distribution is authorized, the distribution can promptly be implemented.

Similarly, before the Court authorizes distribution to the Second Wave Accounts, the Trustee should report to the Court (1) what validity tests his professionals have completed with respect to those customer accounts, (2) the results of those tests, and (3) the analysis supporting his conclusion that such testing is sufficient to reasonably assure a proper distribution with respect to those larger accounts. Where certain customers require further analysis, the Trustee should identify the steps he intends to take to validate such customers' accounts before making distributions to those customers. The report should be filed at least five business days before the hearing at which authorization of that distribution is considered.

The CFTC does not favor unnecessarily delaying customer distributions, and believes that the innocent customers of the Debtor should be compensated for their losses as soon as reasonable and practicable. Nonetheless, caution is warranted to ensure that the books and records of the Debtor may be relied upon to avoid the possibility of distributions based on fictitious data. This is especially true given the magnitude of the proposed distributions -- \$123 million.

In the Distribution Motion, the Trustee states the he considered “due diligence” factors. *See* Distribution Motion (Dkt. 147) at ¶ 18. The factors set forth by the Trustee do not address the CFTC’s concerns. For example, the Distribution Motion states that the distribution would be made in reliance on a Social Security Number “verification process [that] has been in place at the Debtor for many years.” *Id.* ¶ 18.A. But reliance solely on pre-petition verification systems at the Debtor is not advisable where there is strong evidence of falsification of books and records under the authority of the Chief Executive Officer, as well as ineffective accounting and operational controls, and thus a very real reason to fear fictitious customer accounts. Indeed, none of the “due diligence” factors set forth by the Trustee address verification of the accuracy of the Debtors’ books and records.

Moreover, the Distribution Motion asserts that the CFTC has “authorized” the proposed distributions. *See* Distribution Motion (Dkt. 147), ¶ 30. That is not yet the case. While, as stated above, the CFTC strongly favors making customer distributions, and believes that the Debtor’s customers are rightly concerned about accessing as much as possible of their money as soon as possible, testing of the validity of the Debtors’ books and records is necessary before they can be relied upon to support such a distribution, to avoid a mis-distribution of customer funds.

CONCLUSION

The CFTC believes that the foregoing approach appropriately balances the important goals of distributing funds to the legitimate futures customers of Peregrine Financial Group as soon as is practicable, while providing reasonable assurance that such funds will not be not misdirected.

Dated: September 9, 2012

Respectfully submitted,

UNITED STATES COMMODITY
FUTURES TRADING COMMISSION

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CERTIFICATE OF SERVICE

I hereby certify that on this date I caused to be served a true copy of the foregoing **STATEMENT OF THE COMMODITY FUTURES TRADING COMMISSION IN SUPPORT OF THE TRUSTEE'S MOTION FOR AN ORDER APPROVING TRANSFERS AND INTERIM DISTRIBUTIONS TO CERTAIN COMMODITY CUSTOMERS OF THE DEBTOR** on the following persons in the manner indicated.

/s/ Anne W. Stukes

The following is the list of **parties** who are currently on the list to receive email notice/service for this case by the court's CM/ECF system.

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Via Electronic Mail on September 9, 2012 and U.S. Mail on September 10, 2012

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