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UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF FLORIDA
ORLANDO DIVISION

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U.S. DISTRICT COURT
MIDDLE DISTRICT OF FLORIDA
ORLANDO, FLORIDA

SECURITIES AND EXCHANGE *
COMMISSION *

Plaintiff

v.

CIVIL ACTION FILE NO:
6:06-cv-137-Orl-19 KRS

EDWARD S. DIGGES, JR., et al.,

Defendants

* * * * *

**REPLY MEMORANDUM IN SUPPORT OF
MOTION TO SET ASIDE ENTRY OF DEFAULT**

Defendant Edward S. Digges, Jr., pro se, pursuant to the Court's Order (D.E. # 88), submits this Reply Memorandum in Support of his Motion to Set Aside Entry of Default.

INTRODUCTION

An entry of default should be set aside where a defendant meets a "bare minimum" of showing "good cause" under Rule 55(c), such as the existence of meritorious defenses, prompt action by defendant after entry of the default, and the lack of prejudice to the adverse party. *See Compania Interamericana Export-Import, S.A. v. Compania Dominicana de Aviacion*, 88 F.3d 948, 951-52 (11th Cir. 1996); *Jones v. Harrell*, 858 F.2d 667, 669 (11th Cir. 1988). Here, Plaintiff has failed to rebut Defendant's satisfaction of this minimum standard.

I. DIGGES HAS BOTH MERITORIOUS FACTUAL AND LEGAL DEFENSES.

Plaintiff's response to the existence of meritorious defenses in this case consists of the bald statement that, "the Receiver has confirmed [that] the venture devolved into a ponzi scheme." Opposition 10. This self-serving conclusion, however, ignores the evidence that

even Plaintiff admits establishes nothing more than a failed business venture, not a scheme to defraud.

The credit card terminal venture at the heart of this case was an actual, ongoing enterprise with revenue-generating capabilities. Digges Declaration ¶ 2 (Exhibit A hereto). The venture sold terminals to purchasers who had the option to lease them back to the venture for placement with merchants. Terminals placed with merchants generated revenue when used to process point-of-sale purchases. The venture was designed to use this revenue to pay both operating expenses and obligations to terminal owners; however, because the quality and quantity of terminal placements with merchants lagged behind expectations, the venture encountered serious cash flow problems, which prevented it from meeting its obligations to terminal purchasers. *Id.*

Even the SEC admits that the venture only ran into operating deficits “as a result” of terminals not being placed with enough merchants (Opposition 4), and describes the venture as having “devolved” into an alleged Ponzi scheme (Opposition 10), a verb which implies that the venture had legitimate origins and purposes. In sum, there are facts which support the defense that the venture was simply a flawed business, and there was no intent to defraud. Accordingly, under Rule 55(c), the default should be set aside so that this meritorious defense can be heard. *See Compania, supra.*

In addition, Plaintiff’s mischaracterizes the state of the law as to whether a “sale-leaseback” like the one at issue is a “security.” In fact, the law regarding this issue is unsettled with the federal circuits split on whether or not a “horizontal” or “vertical” commonality test applies. *Compare S.E.C. v. Infinity Group Co.*, 212 F.3d 180 (3d Cir. 2000) (horizontal commonality) *with United States v. Dale*, 374 F.3d 321 (5th Cir. 2004) (vertical commonality). Here, the sale-leaseback arrangements were all conducted by Delaware LLCs, and thus subject to

the law of the Third Circuit under which a venture of this type is not a “security.” *See Infinity Group Co., supra.*

Plaintiff’s claim that the Supreme Court “unanimously held that a program virtually identical to the Digges venture was a security” in *S.E.C. v. Edwards*, 540 U.S. 389 (2004) (Opposition 11) is also wrong. *Edwards* simply held that a “sale-leaseback” offering may qualify as a “security,” but the case was remanded without resolving the “horizontal” versus “vertical” commonality split among the circuits.¹ Thus the applicability of federal securities law to the venture at issue in this case is far from settled. At the very least, the issue is debatable and not the unquestioned legal proposition Plaintiff asserts.

II. PLAINTIFF WILL NOT SUFFER ANY PREJUDICE BY SETTING ASIDE THE ENTRY OF DEFAULT.

Plaintiff cannot show any prejudice from being required to litigate its claims against Defendant. Defendant acted promptly to set aside the default entered on April 5, 2006 by filing his first Motion fifteen days later, on April 20, and later filing an Answer to the Complaint on April 26. Since then, Digges has fully participated in this case as a party, sitting for three full days of deposition examination by the Receiver, answering the Receiver’s discovery requests, participating in scheduling conferences, and otherwise fully cooperating in this litigation.

The only prejudice alleged by Plaintiff is (a) “[granting the Motion] will force the Receiver to continue litigating this case”; and (b) “the Receiver’s resulting fees will reduce any recovery for investors.” Opposition 14. Both are groundless. Requiring Plaintiff to prove its case can hardly be prejudicial, especially where Digges has meritorious defenses to both Plaintiff’s factual and legal claims. *Walter E. Heller Western, Inc. v. Seaport Enterprises, Inc.*, 99 F.R.D. 36,

¹ The district court later determined that, under the “broad vertical commonality test,” the venture in *Edwards* qualified as a security. The Eleventh Circuit affirmed. *S.E.C. v. ETS Payphones, Inc.*, 408 F.3d 727 (11th Cir. 2005). The Supreme Court has yet to resolve the split in the circuits on the appropriate test to use.

37 (D. Or. 1983); *Nash v. Signore*, 90 F.R.D. 93, 94 (D. Pa. 1981). As for fees, the Receiver will continue to generate fees in this action regardless whether Digges' default is set aside, as there are multiple defendants in both this and the ancillary action undertaken by the Receiver, including Digges who is a defendant in the ancillary case. Thus, in the absence of any prejudice to Plaintiff, the default should be set aside.

III. THERE HAS BEEN NO "WILLFULNESS" BY DIGGES.

Plaintiff alleges that Digges' failure to timely answer the Complaint was willful because "his counsel" (Gerard Martin) accepted service of the summons and complaint. Opposition 8. However, as set forth in papers filed in connection with Mr. Martin's Motion to Withdraw Appearance (D.E. ## 63, 64), Mr. Martin never represented Digges in this action. His acceptance of service of the Complaint was solely to accommodate the SEC. Martin Declaration ¶¶ 4, 5 (Exhibit B to Response to Order to Show Cause, D.E. # 63). Indeed, as Mr. Martin attests, he was precluded from representing Mr. Digges in this matter because of conflicts of interest arising from his prior representation of Receivership Entities. Martin Declaration ¶ 5; Motion to Withdraw Appearance ¶ 2 (D.E. # 64).²

Plaintiff also claims that willfulness can be inferred by Digges' alleged violations of the Court's Order freezing assets, citing (a) a withdrawal from an IRA account; (b) the purchase of a car; and (c) the sale of property owned by Chilham, LLC ("Chilham"). Opposition 9.

Initially, it should be noted that with the exception of the sale of property by Chilham, these alleged violations were not part of the SEC's recent contempt motion, raising the issue whether the SEC now even views them as evidence of willfulness. In any event, the IRA account in question belonged to Digges' wife Katherine Kerr, not Digges, Digges Declaration ¶

² It would also be highly inequitable to use Mr. Martin's accommodation to Plaintiff (which was done "to save [the SEC] and Mr. Loomis the time and expense involved with serving the complaint and other initial pleadings on the multiple defendants") (Martin Declaration ¶ 4) against Digges in this regard.

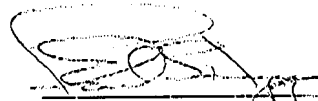
4, and Ms. Kerr's request for liquidation of this account took place before the Court's Order was entered.³ *Id.* Plaintiff's allegation about the purchase of the car is equally baseless, as it was purchased in the Fall of 2005 (months before the Order was entered) and delivered on January 10, 2006 (more than a month before the Order). Moreover, all but \$1,000 of the car's purchase price was financed. Digges Declaration ¶ 5.

As for Chilham's sale of real estate, this issue was the subject of the Court's October 16, 2006 show cause hearing. As established at that hearing, (a) Chilham is not a party to this action and has never has been part of the Receivership or subject to the Order; (b) Digges has never been an owner of Chilham (*i.e.*, one of its "Members"), but was only its appointed manager (*see* Chilham Exhibit 1 in show cause hearing, D.E. # 90);⁴ (c) Chilham's decision to sell real estate assets was made by its Members; and (d) Digges' role in the sale was limited to the ministerial task of carrying out the direction of Chilham Members. Thus, Digges' actions in relation to a non-party's sale of assets did not violate the Court's Order, and was not willful in any event.

CONCLUSION

For all of the foregoing reasons, the entry of default should be set aside.

Respectfully submitted,



Edward S. Digges, pro se

³ Digges' defined benefit plan account has remained intact and untouched since the Order. Digges Declaration ¶ 4.

⁴ Effective October 23, 2006, Chilham removed Digges as its manager. *See* Exhibit B hereto.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing Reply Memorandum in Support of Motion to Set Aside Default was mailed via First Class Mail this 25th day of October, 2006 to the following:

James D. Silver, Esquire
Michael A. Shafir, Esquire
Carlton Fields, P.A.
Bank of America Tower
at International Place
100 S.E. Second Street, Suite 4000
Miami, FL 33131

William P. Hicks, Esquire
Jack Westrick, Esquire
Securities and Exchange Commission
3475 Lenox Road, NE, Suite 500
Atlanta, GA 30326-1232

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Edward S. Digges, pro se

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SECURITIES AND EXCHANGE
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Plaintiff

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EDWARD S. DIGGES, JR., et al.,

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Defendants

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* * * * *

DECLARATION OF EDWARD S. DIGGES, JR.

I, Edward S. Digges, Jr., submit this unsworn declaration under penalty of perjury pursuant to 28 U.S.C. § 1746.

1. I am a defendant in this action and the movant to set aside the entry of default entered against me on April 5, 2006.

2. The structure, purpose, and history of the credit card terminal venture at the heart of this case has been described at length in testimony by various deponents in this action, including Louis Haug, Edward M. Golodetz (co-managing director of the venture who was in charge of terminal placement), and myself. As set forth in that testimony, prior to the filing of this action by the SEC and the appointment of the Receiver, the venture was an ongoing enterprise with revenue-generating capabilities. The venture sold terminals to purchasers who had the option to lease them back to the venture for placement with merchants. Terminals placed with merchants generated revenue when used to process point-of-sale purchases. The venture was designed to use this revenue to pay both operating expenses and obligations to terminal owners. However,


because both the quality and quantity of terminal placements with merchants lagged behind expectations, the venture encountered a serious cash flow problem, which prevented it from meeting its operational costs and lease payments to purchasers.

3. In response, the venture began exploring alternative business models, including (a) testing a new line of wireless terminals which would have opened up additional, highly profitable markets for the venture (e.g., restaurants, tour operators, etc.); (b) refining its business plan to improve the quality and quantity of terminal placements; and (c) soliciting additional capital investment from outside investors to put the venture on sound financial footing, including the payment of existing lease and redemption obligations to terminal owners. Indeed, outside investors were already in the process of completing their due diligence when this action began in February 2006. As a result of the appointment of the Receiver on February 15, 2006, however, these efforts at improving the financial viability of the venture were halted.

4. The IRA account discussed at page 9 of the S.E.C.'s Opposition to my Motion to Set Aside Entry of Default ("Opposition") was a defined benefit plan that belonged to my wife, Katherine Kerr, not to me. She made her request for liquidation of this account on February 7, 2006, and she received a check for the account proceeds a few days later (approximately \$40,000). My own defined benefit plan account has remained intact and untouched since entry of the Court's Order.

5. The "luxury car" referred to on page 9 of the Opposition is a Mercedes ML 500. It was purchased in September or October 2005 and delivered on January 10, 2006. All but the initial \$1,000.00 down payment was financed.

I declare under the penalties of perjury that the foregoing is true and correct. Executed on
October ^{25th}, 2006.



Edward S. Digges, Jr.

RESOLUTION TO REMOVE MANAGER

WHEREAS, Edward S. Digges, Jr. has served as the Manager of Chilham, LLC since on or about January 2, 2001; and

WHEREAS Members holding 100% of the Voting Interests of Chilham, LLC on this 23rd day of October 2006 have affirmatively voted to remove Edward S. Digges, Jr. as Manager of Chilham, LLC, effective immediately, it is hereby

RESOLVED, this 23rd day of October 2006 that Edward S. Digges, Jr. be, and hereby is, removed as Manager of Chilham, LLC and that Edward S. Digges, Jr. shall cease to have or exercise the powers thereof, effective immediately.

WITNESS OR ATTEST

MEMBERS

KBK PARTNERSHIP, LLP



By: Katherine A. Kerr
Katherine A. Kerr, Managing Partner



Katherine A. Kerr
Katherine A. Kerr, Member

STATE OF Maryland
COUNTY OF Dorchester

I hereby certify that on the 23rd of October, 2006, before me, the subscriber, a notary public of the State of MD, in and for Dorchester Co., personally appeared Katherine A. Kerr who executed the foregoing instrument for the purposes therein contained.

As witness, my hand and notarial seal

Michelle R. Plummer
Notary Public
My Commission Expires 3/1/07

