

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

* * * * *

**OPPOSITION TO RECEIVER’S FIRST INTERIM APPLICATION
FOR FEES AND COSTS THROUGH MAY 31, 2006**

Defendant Edward S. Digges, Jr., *pro se*, submits this Opposition to Receiver’s First Interim Application for Fees and Costs Through May 31, 2006 (the “Application”).

1. On February 14, 2006, the Court entered an Order, *inter alia*, appointing James D. Silver as Receiver and ordering him “to efficiently administer and manage the Receiver Estate,” which consists of the assets of various defendant entities. As demonstrated below, however, the Receiver’s eight-month tenure has been anything but efficient. Rather, he has amassed nearly \$500,000 in legal and professional fees in the first 100 days of this litigation with little to show for it.

2. Prior to the filing of this action by the SEC and the appointment of the Receiver, the credit card terminal venture at the heart of this case was an ongoing enterprise with revenue-generating capabilities. The venture sold terminals to 273 purchasers who leased them back to the venture so that they could be placed with merchants. These placed terminals generated revenue each time they were used to process point-of-sale purchases at merchant locations. The revenue

generated from these merchant transactions was used both to meet the venture's operating expenses and to pay lease and redemption obligations to the 273 terminal owners.

3. 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. 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); (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 the 273 terminal owners. Indeed, outside investors were already in the process of completing their due diligence when this action began in February 2006.

4. 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. Immediately upon his appointment, the Receiver seized all the venture's books and records, computer systems, inventory, and bank accounts. He halted all placements of existing credit card terminals and the testing of the new wireless terminal. He terminated all of the venture's key personnel. He refused all offers of assistance from the venture's prior management team and blocked it from continuing its efforts to secure new markets, new placements, and new outside investors. As a result, the only revenue the Receivership Estate is currently receiving (approximately \$17,000 a month) comes from actions taken by Defendants prior to the Receiver's appointment. See First Report of the Court-Appointed Receiver ¶ 51 (D.E. # 33) ("First Report").

5. The Receiver also began expensive, inefficient, and time-consuming discovery both in this case and in a separate, ancillary action in this Court against individuals involved in the venture and their families (Silver v Digges, et al., Case No. 6:06-cv-290). In both actions, the Receiver has taken lengthy, multi-day depositions of people involved with the venture, but to date, he has failed to complete any of these depositions.¹ According to the Application, the Receiver has used nine different attorneys and nine different legal assistants at two different law firms, at rates as high as \$460 per hour. As a result of the manner in which the Receiver has been litigating these two cases, two defendants in the ancillary action have been forced to discharge their counsel and proceed pro se.²

6. After more than eight months, the Receiver has little to show for his efforts except an interim fee application totaling \$473,963.28. No hidden assets or secret bank accounts have been located, and it is curious why the Receiver has expended so much effort attempting to locate such assets when Defendant has truthfully represented from the beginning that none exist. The assets of the Receivership Estate remain what they were before the Receiver took over: approximately \$70,000 in cash and monthly revenue of \$17,000, all generated by the efforts of the prior management team. First Report ¶¶ 49-51. Thus, if the Application is granted, the Receiver will

¹ The deposition of Paul Hoffman, the venture's chairman, went for two full days and adjourned without completion. The deposition of Debbie Doll, the venture's controller, lasted one complete day and has been recessed to an undetermined date in the future. The deposition of Louis C. Haug, the venture's CFO, consumed two full days without completion. The deposition of Edward M. Golodetz, who ran the terminal placement side of the venture, took another two full days and failed to finish. The deposition of this defendant was recessed by the Receiver after three full days. In none of these depositions has the Receiver managed to finish his direct examination or allow other counsel to begin their cross-examination. This appears to be a deliberate strategy by the Receiver to keep depositions open in violation of Fed.R.Civ.P 30(d)(2) which limits a deposition to one day of seven hours, unless otherwise authorized by court or stipulated by the parties (neither condition existing in this case). Defendant and counsel for other defendants raised this issue with the Magistrate Judge during the Rule 26 conference, who, rather than setting specific guidelines, stated that he was relying on the good faith of counsel to complete the depositions in an expeditious manner.

² Richard McGonigle (see D.E. #103). Counsel for another defendant in that action, Bruce McGonigale, has also recently informed counsel and parties by email that he will shortly be withdrawing his appearance with his client proceeding pro se.

completely exhaust the entire corpus of the Receiver Estate plus all of its revenue for the next two years.

7. Moreover, given that the current Application only covers fees and expenses through May 31, 2006, one can only speculate how much additional fees have been expended by the Receiver since then, especially in light of the lengthy (and unfinished) depositions and other actions taken by the Receiver in the subsequent 120 days.

8. At his current “burn rate,” and considering the assets available, the Receiver will never be able to collect funds sufficient to pay both his fees and provide any recovery for purchasers of the terminals, assuming he prevails on the merits of this action.³ The only possible source of funds derive from the personal assets of the defendants in the ancillary action, but even the Receiver concedes that these amount to only \$3.1 million. See First Report ¶ 52.⁴ Moreover, this figure includes real estate held by family trusts acquired long before the credit card terminal venture began. Because no money from these ventures was ever used to acquire or maintain these properties, they are outside the reach of a disgorgement action. See S.E.C. v. Cavanagh, 155 F.3d 129, 136 (2d Cir 1998) (property of a relief defendant is subject to recovery in SEC enforcement action only where the defendant does not have a legitimate claim to that property). None of the other defendants in this case or the ancillary action have any significant assets.


³ In this action, the SEC alleges that the sale/lease-back manner in which the terminal venture was structured constitutes a security under federal securities laws. That legal issue is unsettled, with the federal circuits split on whether or not a “sale/leaseback” transaction such as involved in this venture qualify as a “security.” The federal circuits diverge on whether “horizontal commonality” is required versus a “vertical commonality” test. Compare SEC v. Infinity Group Co., 212 F.3d 180 (3d Cir. 2000) (horizontal commonality required) with United States v. Dale, 374 F.3d 321 (5th Cir. 2004) (vertical commonality required). The Supreme Court had a chance to resolve the issue when it granted cert in SEC. v. ETS Payphones, Inc., 300 F.3d 1281 (11th Cir. 2002), but it reversed on other grounds and remanded to the Eleventh Circuit. SEC. v. Edwards, 540 U.S. 389, 124 S.Ct. 892, 157 L.Ed.2d 813 (2004). The issue remains unresolved.

⁴ In fact, Defendant testified at his deposition that the actual market value of his unencumbered assets is less than \$2 million.

9. The Receiver's actions have also foreclosed all possibilities of a business resolution to this dispute involving the infusion into the venture of new capital from outside investors and a revised business model. Defendant submits that this approach is the only viable resolution for this case, and the only outcome with any hope of providing money for the benefit of investors, many of whom are elderly. However, such a business resolution is impossible as long as the Receiver continues to deplete the Estate with huge litigation expenses in pursuit of imaginary wealth.

10. Excessive fees in SEC disgorgement cases have been criticized by the courts and Congress in other cases. See S.E.C. v. Goren, 272 F.Supp.2d 202, 213-214 (E.D.N.Y. 2003). There, the court substantially reduced a receivership fee application amounting to 85% of the estate assets. As noted by the court, Congress's General Accountability Office has criticized receivership fees amounting to 54% of the common fund. Id. Here, the fees are currently more than 600% of the common fund, and climbing.

11. Defendant Digges, therefore, respectfully requests that this Court refer the Receiver's First Application to the Magistrate Judge for review and recommendations, as was done in S.E.C. v. Goren, supra. Not only will the Magistrate Judge be able to scrutinize the Application for redundant, inflated, and unnecessary costs, but the Magistrate Judge can exercise this Court's supervisory power over the Receiver and the Receivership to insure that it is being conducted with the best interests of the parties and the alleged victims in mind.


Edward S. Digges, pro se

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing Opposition to Receiver's First Interim Application for Fees and Costs Through May 31, 2006 was mailed via First Class Mail this 4th day of October, 2006 to the following:

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