UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF FLORIDA
ORLANDO DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

EDWARD S. DIGGES; NEXSTAR COMMUNICATIONS, LLC; TMT EQUIPMENT COMPANY, LLC; TMT MANAGEMENT GROUP, LLC; POSA, LLC; POSA TMT, LLC; TELEVEST COMMUNICATIONS, LLC; TELEVEST GROUP, LLC; AND SPIN DRIFT, LLC,

Defendants.

CIVIL ACTION FILE NO. 6:06-CV-137-ORL-19-KRS

SECURITIES AND EXCHANGE COMMISSION'S OPPOSITION TO EDWARD S. DIGGES' PRO SE MOTION TO SET ASIDE ENTRY OF DEFAULT

Defendant Edward S. Digges ("Digges"), a recidivist violator, orchestrated a ponzi scheme between April 2003 and February 2006, raising at least $20 million from more than 300 investors. Digges misappropriated at least $4.1 million of the proceeds raised, using them to pay his personal expenses, and other expenses of his wife and children. Although Digges is a former litigator, and therefore familiar with the federal rues of civil procedure, he did not file his answer to the complaint by the Securities and Exchange Commission ("SEC") until almost two months after the time required. As a result, the Clerk entered default on April 5, 2006.

Digges now seeks to vacate this entry of default, asking the Court to excuse his tardiness because he was unable to retain a lawyer to timely answer the complaint. But Digges ultimately filed a pro se answer on April 26, 2006 and never explains why he could not have done this within the required time. Digges also suggests that he has meritorious defenses to the claims against him, arguing that (1) the Court lacks subject matter jurisdiction because his investment program was not a "security," and (2) that he lacked scienter because he though his program offered a legitimate investment opportunity. Neither of these defenses pass even a cursory scrutiny. The Eleventh Circuit found a nearly identical scheme to be a security, and Digges' own lawyer conceded that Digges' program was a security. Moreover, Digges never disputes that he knowingly misrepresented and omitted material facts regarding his investment program.

For these reasons, the Court should deny Digges' motion to set aside the entry of default.

I. FACTS

A. Digges' Investment Program

From at least April 2003 through February 2006, Digges and the other Defendants that Digges controlled ("the Digges Entities") sold approximately $20 million of investments in point-of-sale terminals to more than 300 investors throughout the United States, many of whom are elderly. First Interim Report of the Court Appointed Receiver ("Receiver Report") at ¶ 1. Point-of-sale terminals are instruments typically placed at retail establishments, which merchants use to

swipe customer credit, debit, or gift cards. Id. The terminals verify whether a customer has sufficient available credit or funds to make a particular purchase. Id.

The investments were structured so that an investor purchased terminals from an entity controlled by Digges for $5,000 and simultaneously entered into a leaseback agreement with another entity controlled by Digges. Id. at ¶ 2. Under the leaseback agreement, the investor was to receive monthly lease payments of $50, representing a 12% annual return, for five years. Id. at ¶ 2. The entity leasing the terminal also offered to repurchase each terminal at the end of the lease for $5,000. Id. at ¶ 3. Virtually all investors elected to enter into the leaseback arrangement and received a monthly income stream. Id. at ¶ 4. Digges' offering materials claimed that it would fund the lease payments and repurchase by placing the terminals at retail outlets and receiving a fee whenever the merchant used the terminal. Id. at ¶ 5.[1]

B. Digges' Misrepresentations and Omissions

The offering materials prepared by Digges represented that the lease payments were "assured," in part because the Digges Entities established a "reserve fund" to fund the lease payments. Exhibit "A" to Declaration of Neal Seiden, filed in connection with the SEC's February 2, 2006 Emergency Application for Temporary Restraining Order (hereinafter "Seiden Declaration") at p. 2, 8, 14, 20. Digges also made this representation to sales agents selling his

securities. Declaration of Chris Morris, filed in connection with the SEC's February 2, 2006 Emergency Application for Temporary Restraining Order Digges also told sales agents that there was a reserve fund to cover the repurchase of the terminals. Exhibit 1 to Receiver Report. In truth, neither Digges nor any of the Digges Entities ever established a reserve fund. Receiver Report at ¶ 29.

Contrary to Digges' representations, the lease payments to investors and repurchase of their terminals were far from "assured." Digges actually placed with merchants less than half of the terminals sold to investors, and the remaining terminals that the investors purchased sat on a shelf, generating no revenue. Receiver Report at ¶ 22. As a result, Digges' investment program began running a deficit as early as January 2004, and that deficit reached $175,000 per month in the first quarter of 2005. Id. at ¶ 25 and Exhibit 5 to Receiver Report. In internal e-mails, Digges admitted that these losses caused severe financial problems. Id. at ¶¶ 25, 28 and Exhibit 5 to Receiver Report. Digges never disclosed these mounting losses to investors, or told investors that, to cover these losses, he used new investor money to make the lease payments to investors. Id. at ¶¶ 27, 32.

Nor did Digges disclose to investors that the state securities commissions of Maryland and Pennsylvania issued Summary Orders finding that one or more Digges Entities violated state securities laws by engaging in the offering. Exhibit 5 to Receiver Report at p. 3 Finally, Digges' offering materials touted the

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[1] The lawyer for the Digges Entities acknowledged that there was "no doubt" in his mind that this sale lease-back program qualified as a security. Exhibit 1 to Receiver

continued . . .

experience and integrity of management, claiming "Nexstar is composed of experienced business executives who bring together relevant business experience, strategic planning capability key business development and financing relationships and vision." Exhibit "D" to Seiden Decl., p.3. The offering materials concealed Digges' involvement in the program, and failed to disclose Digges' (1) 1990 conviction for mail fraud, which arose from his over-billing a client, and (2) 1989 civil judgment for fraud, deceit and breach of contract, which ordered Digges and his law firm, jointly and severally, to pay $3,634,801.92, including $510,386.99 in prejudgment interest. Exhibit "E" to Seiden Decl.; Dresser Indust. v. Digges, 1989 WL 139234 (D. Md. Aug. 30, 1989)[2]

C. Digges Misappropriated Investor Funds

Digges also failed to tell investors that he diverted at least $4.1 million of their money to pay personal expenses for his wife, children and himself. Receiver Report at ¶ 41. For example, Digges used the funds to purchase real estate that he or his wife owned or controlled, or to pay the mortgages on those properties. Id. at ¶ 45. He also used investor proceeds to pay student loans for his children or step children. Id. at ¶ 47. Digges also used over $1 million of investor funds toward construction expenses associated with his and his wife's personal propoerties. Id. at ¶ 48. In perhaps the most egregious example of misappropriation, Digges used investor proceeds to complete the purchase of a $250,000 sailing boat while, at the

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Report at p.

same time, he withheld lease payments to investors due to a shortage of funds. Id. at ¶ 46.

Despite raising at least $20 million from this investment program, the receivership estate in this matter currently has assets worth less than $71,000. Receiver Report at ¶ 49. Digges' wife and two other that Digges created and controlled, KBK Partnership, LLP and Chilham, LLC, have real estate and a boat with combined equity of approximately $3.1 million. Id. at ¶ 52. Digges diverted substantial investor proceeds to his wife, KBK and Chilham during the course of his fraudulent offering, without those parties providing anything of value in return. Id. at ¶ 38, 41. The Receiver in this matter has filed suit against these parties in a separate lawsuit to recover those funds. Silver v. Digges, et al., Case No. 6:06-cv-290-Orl-18DAB (M.D. Fl.)

The Receiver owes approximately $20 million to investors, based on the amount raised. Despite the substantial sums which are unaccounted for, the meager assets within the receivership estate, a nd the substantial sums owed to investors, Digges has asked the Receiver to release approximately $1.3 million, or more than 30% of the frozen assets, to cover his living and legal expenses. The SEC declined this request.

D. Digges Violates the Asset Freeze

Digges admits that he was served with a copy of the complaint on February

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[2] Digges, a former products liability litigator, was disbarred as a result of his conviction. Exhibit "F" to Seiden Decl.

2, 2006, Affidavit o Edward S. Digges, Jr. at ¶ 1, and his attorney accepted service of the summons and complaint and other pleadings on behalf of Digges and the Digges Entities on February 6, 2006. On February 15, 2006, this Court entered a consent order that, among other things, froze all assets "under the control of the Defendants" and appointed a receiver for the assets held by the Digges Entities. The SEC served a copy of this consent order on Digges' attorney via electronic mail on that day. See Ex. 1 hereto.

Despite the order freezing assets, Digges emptied funds from several bank accounts that were subject to the freeze. Receiver Report at pp. 18-19. He also withdrew the $40,000 in his wife's retirement account, even though that account was funded from proceeds of the fraudulent offering at issue in this litigation. Id. Digges also purchased a luxury vehicle after he had already consted to the asset freeze in this case.

Because Digges did not file an answer within 20 days after service of the complaint, the SEC filed its application for entry of default on March 30, 2006. The Clerk entered default on April 5, 2006. The Commission has withheld filing a motion for default judgment until the Receiver can quantify the appropriate amount of disgorgement. See Rule 55(b)(2) of the Federal Rules of Civil Procedure. This process has been complicated because Diges regularly shifted proceeds between a myriad of bank accounts (over 100) held by numerous entities that Digges controlled. Receiver Report at ¶¶ 32-39.

II. DISCUSSION

A. Digges Has Not Shown "Good Cause" to Vacate the Default

Rule 55(c) of the Federal Rules of Civil Procedure provides that the Court with discretion to vacate a default upon "good cause shown." In deciding whether the Digges has shown "good cause," this Court must find:

> (1) there was excusable neglect on the part of the defaulting party for not answering the complaint; (2) the defaulting party responded promptly after notice of the entry of default; (3) setting aside the default will not prejudice the non-defaulting party; and (4) the defaulting party had a meritorious defense.

Woodbury v. Sears, Roebuck & Co, 152 F.R.D. 229, 236 (M.D. Fl 1993). In the present matter, Digges cannot show at least two of these elements: (1) excusable neglect and (2) a meritorious defense.

1. Digges Willfully Failed to Answer the Complaint

Digges admits that he was served with the complaint on February 2, 2006. Digges Aff. at ¶ 1. His counsel accepted service of the summons and complaint on February 6, 2006. The summons directed Digges to file an answer within 20 days after service, or by February 27, 2006. Because Digges is a former litigator, he obviously understood the consequences if he failed to answer timely. The Court should thus view his tardiness as willful. See U.S. v. Nalls, 177 F.R.D. 696, 698 (S.D. Fl. 1997) (failure timely to answer was culpable because summons clearly required answer within 20 days after summons). The Court may also infer willfulness from Digges' intentional disregard of this Court's order freezing his assets. Nalls, 177 F.R.D. at 698 n.5 (finding willful refusal to answer complaint in

part because "there is also some indication that defendant may have initially attempted to avoid the effect of the TRO.") After the Court entered the asset freeze, Digges violated that order by withdrawing funds from several bank accounts to which the freeze applied.

Digges' only excuse for his tardiness is that he was unable to hire a lawyer to answer the complaint for him. Memorandum in Support of Edward S. Digges' Pro Se Motion to Set Aside Entry of Default ("Digges Memo") at p. 4. Yet Digges ultimately filed a pro se answer on April 26, 2006, even though he still had not retained counsel. Digges does not explain why he could not have filed a pro se answer within the required time.

2. Digges Has No Meritorious Defense

Digges asks the Court to vacate the default because he has two meritorious defenses to the claims against him. First, he argues that his investment program may not qualify as a security. Digges Memo. at p. 4. But the Eleventh Circuit has ruled that a sale lease-back program substantially similar to the Digges program qualified as a security. SEC v. ETS Payphones, Inc., 408 F.3d 727 (11th Cir. 2005). Even the former lawyer for the Digges Entities acknowledged that, in light of the ETS decision, there was "no doubt" that Digges' program qualified as a security. Exhibit 1 to Receiver Report at p.2. Digges has not and cannot identify anything that distinguishes his investment program from the program at issue in the ETS case.

Digges next suggests that he lacked scienter because he "legitimately

believed that a legitimate product was being sold that was designed to provide a benefit to purchases." Digges Memo at p. 5. Digges' statement offers no defense to the SEC's claim that Digges knowingly misrepresented and omitted material facts in connection with the offer and sale of the sale lease-back program.

Where a defendant disseminates known falsehoods or omissions, the defendant has the necessary scienter to establish a violation of the antifraud provisions of the federal securities laws. SEC v. Carriba Air, Inc., 681 F.2d 1318, 1324 (11th Cir. 1982). The complaint in this matter alleges several material misrepresentations and omissions by Digges: (1) the existence of a "reserve fund" or "sinking fund" to ensure the lease payments to, and ultimate repurchase of terminals from, investors, when no such fund ever existed; (2) the "assurance" of lease payments when the program was actually losing substantial sums on a monthly basis; (3) the experience and integrity of management even though Digges was a convicted felon who has been disbarred; and (4) the state cease-and-desist orders, one of which found that the offering involved fraud. Complaint at ¶¶ 47 – 61. Because Digges does not dispute these allegations, his purported "good faith" belief in the success of his program is irrelevant. Greenhill v. United States, 298 F.2d 405, 411 (5th Cir. 1962) ("The law is that honest belief in the ultimate success of the venture will not justify false representations in the sale of securities.")[3]

Because Digges has not shown excusable neglect or a valid defense to the

[3] Fifth Circuit decisions prior to 1981 are binding on this Court. Bonner v. City of Pritchard, 661, F.2d 1206, 1207 (11th Cir. 1981).

SEC's claims, the Court should deny his motion to set aside the default. Nalls, 177 F.R.D. at 698 (refusing to vacate default where no excusable neglect or meritorious defense shown); Boron v. West Texas Exports, Inc., 680 F. Supp 1532 (S.D. Fla. 1988) (same). Moreover, Digges' failure to show excusable neglect or a meritorious defense obviates the need for the Court to consider the other two elements of "good cause", i.e., whether the SEC will suffer prejudice if the default is vacated or whether Digges promptly remedied his default. Insurance Co. of North America v. Morrison, 156 F.R.D. 269, 272 (M.D. Fla. 1994) (in refusing to set aside default where no excusable neglect was shown, court opined "all [four good cause] factors must be found in the defaulted party's favor to grant the relief sought."); Almacen Boyaca CIA.LTDA v. Gran Golfo Exp., 771 F. Supp. 354, 375 (S.D. Fla. 1991)(in refusing to vacate entry of default, court declined to consider all four good cause facts, finding only that defendant had no meritorious defense and failed to promptly address the default).[4]

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[4] Digges insinuates that the SEC and the Receiver have unreasonably refused to release assets from the freeze, which he claims has "prevented [him] from meeting his basic needs and expenses and retaining counsel to defend in this litigation." Digges Memo at 2. However, the assets subject to the freeze, which might be used to repay investors, totals approximately $3.1 million, far less than the amount needed to repay investors. Receiver Report at ¶52. Moreover, Digges has asked the SEC and Receiver to release $1.3 million, or more than 30% of the frozen assets, for his living and legal expenses, but has refused to turn over to the Receiver any assets held by the entities he controls, including KBK Partnership, LLP and Chilham, LLC. However, Digges' diverted proceeds from his fraudulent sale leaseback program to these entities , and used those proceeds to either purchase or pay mortgages on the properties that KBK and Chilham owned. Receiver Report at ¶¶ 40-48 The SEC was thus justified in declining Digges' unreasonable offer. SEC v. Quinn, 997 F.2d 287, 289 (7th Cir. 1993) ("[j]ust as a bank robber cannot use the loot to wage the best defense money can buy, so a swindler in securities markets cannot use the victims' assets to hire counsel who will help him retain

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III. CONCLUSION

For the reasons stated herein, the Court should deny Digges' motion to set aside the default.

DATED: May 8, 2006

Respectfully submitted,

s/M. Graham Loomis
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Georgia Bar No. 457868

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the gleanings of crime."); SEC v. Current Financial Services, 62 F.Supp.2d 66, 68 (D.D.C.1999)(finding that the defendant's profit from fraud exceeded $156,000.00 and his frozen funds only amounted to $44,000.00 and denying a motion to unfreeze assets for attorney's fees).

CERTIFICATE OF SERVICE

On May 8, 2006, I electronically filed the foregoing SECURITIES AND EXCHANGE COMMISSION'S OPPOSITION TO EDWARD S. DIGGES PRO SE MOTION TO SET ASIDE THE ENTRY OF DEFAULT with the Office of the Clerk, using the CM/ECF system. Notification of this filing will be served electronically by the Clerk on the following counsel for the Receiver, who has registered in the CM/ECF system and appeared in this case:

Robert N. Gilbert
Carlton Fields, P.A.
222 Lakeview Avenue
Post Office Box 150
West Palm Beach, Florida 33402-0150

I also hereby certify that on May 8, 2006 I caused a copy of the foregoing to be served upon the Defendants, by U.S. Mail, postage pre-paid, to:

Edward S. Digges, Jr.
1 Sandy Acres
Cambridge, Maryland 21613

s/ M. Graham Loomis