IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF GEORGIA
ATHENS DIVISION

SECURITIES AND EXCHANGE COMMISSION,	)	
Plaintiff,	)	
	)	**Civil Action**
v.	)	**No. 3:03-cv-42 (CAR)**
JOHN BENJAMIN STEWART, JR., STEWART FINANCE COMPANY, STEWART NATIONAL FINANCE CO., DONALD N. ELLIS, and D & E ACQUISITIONS, INC.,	)	
Defendants.	)	

ORDER

On November 29, 2004, the Court heard evidence from the parties in reference to Plaintiff's motion to set disgorgement, prejudgment interest, and civil penalties against Defendant Donald N. Ellis. Based upon the findings of fact and conclusions of law set forth below, the Court finds that no disgorgement is appropriate in this case, but assesses a civil penalty against Mr. Ellis, in the amount of $6,500.00.

FINDINGS OF FACT

In the fall of 2001, Defendant John Benjamin Stewart, Jr. hired Donald Ellis to act as Director of Operations for the Stewart Finance Company. Stewart Finance Company was in the business of providing small loans to consumers through a network of locations in several states. Prior to his position at Stewart Finance, Mr. Ellis had a twenty-five year background in manufacturing operations, with no significant experience in finance. He was

paid a salary of $75,000.00 per year. He continued to earn the same salary when he later became President of Stewart National Finance Company, a corporation formed to manage the Stewart Finance Company.

During the period of Mr. Ellis' employment, the Stewart Finance Company became the subject of an investigation by the Securities and Exchange Commission regarding the issuance and sale of unregistered debentures. As a result of the SEC investigation, Stewart Finance was unable to issue additional debentures or roll over existing debentures. It was also unable to pay the debentures upon maturity. In an effort to evade the effect of the restrictions, Mr. Stewart decided to have the debentures rolled over into another company that was not subject to the SEC investigation, a company owned by someone who was not an officer or director of the Stewart companies. Mr. Stewart asked Mr. Ellis to form a corporation in his own name. Acting at Mr. Stewart's request, and with the advice and assistance of attorneys paid by Mr. Stewart, Mr. Ellis formed D & E Acquisitions, Inc. Mr. Ellis invested no personal funds to capitalize the corporation.

D & E was a shell company created for the sole purpose of allowing Stewart to roll over debentures while Stewart Finance and Stewart National were under investigation. It had no assets and no employees, and acted only through the operations of the Stewart Finance Company. All monies rolled over to D & E from the Stewart debentures were immediately transferred back to the Stewart Finance Company. Mr. Ellis continued to perform the same duties he had performed for Stewart Finance and Stewart National – managing the operations of the companies' loan businesses – and continued to receive the same salary. Although Mr. Ellis was purportedly the founder and sole shareholder of D &

E, it was in reality fully funded and controlled by Mr. Stewart at all times, and used for Mr. Stewart's purpose and benefit. D& E remained in business for six months, before the Stewart Companies declared bankruptcy in February of 2003.

CONCLUSIONS OF LAW

A. Disgorgement

In its motion to set disgorgement, Plaintiff asks the Court to order Mr. Ellis to return the salary he was paid during the six months that D & E was in operation, a total of $37,500.00, with interest. Disgorgement is not appropriate in this case, however, because the evidence indicates that Mr. Ellis did not himself receive any unjust enrichment or ill-gotten gain from his activities with D & E, but continued to receive the same salary he had received before, for performing the same work supervising the day-to-day business activities of the Stewart companies. It is apparent that the gains from the illegal securities sales that were facilitated by the D & E transactions went solely to the benefit of Mr. Stewart.

Disgorgement is an equitable remedy within the discretion of courts in adjudicating securities cases. Its purpose is remedial rather than punitive, and it is designed "not to compensate the victims of the fraud, but to deprive the wrongdoer of his ill-gotten gain." SEC v. Blatt, 583 F.2d 1325, 1335 (5th Cir. 1978). "Disgorgement is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws." S.E.C. v. First City Financial Corp., 890 F.2d 1215, 1230 (D.C. Cir. 1989). The focus, therefore, of a disgorgement decision must be on the extent to which the

wrongdoer profited from his wrongdoing, and care must be taken to "distinguish between legally and illegally obtained profits." Id. at 1231.

In this case, there is no indication that Mr. Ellis personally profited from the formation of D & E, or from the scheme of securities fraud orchestrated by Mr. Stewart. Even though he was the named owner of D & E, in reality he was never more than a salaried employee of Mr. Stewart. His income did not increase as a result of the creation of D & E, and his job duties did not change. The real day-to-day business of the Stewart companies continued as it had before. He did not obtain additional stock and the value of his personal stock in the company did not increase. To the contrary, the evidence shows that Mr. Ellis can be numbered among the many victims of the Stewart collapse, as he and members of his family invested approximately $150,000 in the company. The evidence shows that Mr. Stewart, who is now deceased, was the recipient of any unjust enrichment resulting from the D & E transactions. Mr. Ellis has no ill-gotten gains to disgorge.

B. Civil Penalties

Although there is no evidence that Mr. Ellis was himself wrongfully enriched from his actions in forming D & E, his conduct is not without culpability. He allowed his name to be used in the formation of a company that facilitated a scheme by Mr. Stewart to sell unregistered securities. Section 20(d) of the Federal Securities Exchange Act of 1934, at 15 U.S.C. § 78u(d)(3), authorizes courts to impose civil penalties for violations of the Act. The statute defines three tiers of culpability. Penalties may be increased to the "second tier" where the violation "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement," or to the third tier where the violation involved such

fraud or deliberate or reckless disregard of the law and resulted in substantial losses to other persons. Mr. Ellis' culpability in this case merits a penalty in the first tier.

By participating in the creation of D & E in his own name, Mr. Ellis allowed Mr. Stewart to continue the sale of unregistered securities and avoid the final repayment of illegal debentures that the company was unable to repay. Mr. Ellis had reason to suspect that the formation of D& E was at least questionable. It was clearly a shell corporation that served no purpose other than to allow Mr. Stewart to evade certain restrictions imposed in the course of the SEC investigation. Mr. Ellis himself invested no funds in the company and has testified that he spent no more than five or ten minutes a month in the affairs of D & E. All funds delivered to D & E as a result of the debenture roll-overs were immediately transferred back to Stewart Finance.

The details of the transaction should have aroused Mr. Ellis' suspicions about the purpose of the new company. Nevertheless, his conduct was not sufficiently culpable to merit penalties in the second or third tiers. The evidence does not suggest that Mr. Ellis' conduct involved fraud or deceit, or a reckless disregard of the regulatory requirements. In everything, Mr. Ellis acted as a loyal subordinate of Mr. Stewart. He has no background in finance. It appears that he made earnest efforts to prevent the collapse of the business and return the companies to profitability. It is significant that he relied on the advice of Mr. Stewart's counsel, an attorney experienced in securities law and a partner in a major Atlanta law firm. Plaintiff's counsel is correct to suggest that Mr. Ellis would have been well-advised to seek his own counsel in a transaction of such a nature; however his failure to do so was at most negligent, not reckless. His seeking the advice of an experienced attorney,

even if that attorney was employed by another, suggests a degree of regard for the regulatory requirements. Accordingly, a civil penalty within the first tier is appropriate. In this case, Mr. Ellis' culpability warrants the highest penalty within that first tier, and he is hereby ordered to pay to the Treasury of the United States the sum of Six Thousand Five Hundred Dollars ($6,500.00), within sixty days of the date of this Order.

SO ORDERED, this the 6th day of December, 2004.

s/ C. ASHLEY ROYAL
C. ASHLEY ROYAL, JUDGE
UNITED STATES DISTRICT COURT

CW/jec