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Civil Action No.

1 97-CV-2431

JEC

IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF GEORGIA

SECURITIES AND EXCHANGE COMMISSION,  
Plaintiff,  
v.  
WYATT GENE ROSS,  
LYNN K. ROSS, and  
MICKIE E. HIGGINS-HALLKE,  
Defendants.

COMPLAINT FOR INJUNCTIVE AND OTHER RELIEF

It appears to Plaintiff, Securities and Exchange Commission ("Commission"), and it alleges as follows:

OVERVIEW

1. This matter involves gross financial fraud by Wyatt Gene Ross ("Gene Ross") and Lynn K. Ross ("Lynn Ross") (collectively "the Ross brothers"), the two founding officers of Paragon Mortgage Corporation ("Paragon"). The Ross brothers used Paragon, a public company, as their personal piggy bank. Among other things, they misappropriated approximately \$229,040 from Paragon over a five-year period by causing Paragon to repay their personal loans, and by diverting checks to Paragon to their own use.

2. Gene Ross also inflated the financial condition of Paragon on its 1990, 1992 and 1993 financial statements, and Mickie E. Higgins-Hallke ("Higgins-Hallke"), Paragon's chief financial officer, inflated the financial condition of Paragon on its 1992 and 1993 financial statements, by, among other things, failing to record approximately \$258,750 of 1990 compensation expenses representing stock options given to the Ross brothers and

other Paragon employees, altering financial statements filed with the Commission to delete an additional \$200,000 of 1990 compensation expense, altering the 1990 financial statements to increase assets and decrease liabilities by \$200,000, improperly recording \$814,949 in alleged profits from the 1992 sales of loans, improperly recording \$226,484 from the 1993 sale of loans, failing to record \$24,961 in 1992 medical expenses, and recording a \$260,305 gain from a sale in the first quarter of fiscal 1993, even though the sale did not occur until the second quarter of fiscal 1993, resulting in, among other things, the overstatement of income in Paragon's 1990, 1992 and 1993 financial statements which were contained in various reports filed with the Commission by Paragon. Higgins-Hallke knowingly assisted in the scheme. The Ross brothers also concealed their misappropriations on Paragon's books.

3. Shortly before the Ross brothers' misappropriations and their effect on Paragon's financial condition were to come to light, and with knowledge of those misrepresentations and the other financial inaccuracies in Paragon's books and public reports, Gene Ross sold shares of Paragon stock and encouraged family members to do the same, thereby engaging in illegal insider trading and avoiding \$18,264 in losses.

4. Through this misconduct, the defendants violated and are liable for violations of the antifraud, reporting, books and records, and internal accounting control provisions of the federal securities laws; and Gene Ross and Lynn Ross violated the proxy provisions of the federal securities laws, as set forth below.

### VIOLATIONS

5. Defendant Gene Ross has engaged, and unless restrained and enjoined by this Court, will continue to engage in acts and practices which constitute and will constitute violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. 77q(a)], Sections 10(b), 13(b)(5) and 14(a) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. 78j(b), 78m(b)(5) and 78n(a)] and Rules 10b-5, 13b2-1, 13b2-2 and 14a-9 thereunder [17 C.F.R. 240.10b-5, 240.13b2-1, 240.13b2-2 and 240.14a-9], and is liable as a controlling person for violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. 78m(a), 78m(b)(2)(A) and 78m(b)(2)(B)] and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder [17 C.F.R. 240.12b-20, 240.13a-1, 240.13a-11 and 240.13a-13].

6. Defendant Lynn Ross has engaged, and unless restrained and enjoined by this Court, will continue to engage in acts and practices which constitute and will constitute violations of Section 17(a) of the Securities Act [15 U.S.C. 77q(a)], Sections 10(b), 13(b)(5) and 14(a) of the Exchange Act [15 U.S.C. 78j(b), 78m(b)(5) and 78n(a)] and Rules 10b-5, 13b2-1, 13b2-2 and 14a-9 thereunder [17 C.F.R. 240.10b-5, 240.13b2-1, 240.13b2-2 and 240.14a-9], and is liable as a controlling person for violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. 78m(a), 78m(b)(2)(A) and 78m(b)(2)(B)] and Rules 12b-20 and 13a-1 thereunder [17 C.F.R. 240.12b-20, 240.13a-1].

7. Defendant Higgins-Hallke has engaged, and unless restrained and enjoined by this Court, will continue to engage in acts and practices which constitute and will constitute violations of Section 17(a) of the Securities Act [15 U.S.C. 77q(a)], Sections 10(b) and 13(b)(5) of the Exchange Act [15 U.S.C. 78j(b) and 78m(b)(5)] and Rules 10b-5 and 13b2-1 thereunder [17 C.F.R. 240.10b-5 and 240.13b2-1], and is liable as a controlling person for violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. 78m(a), 78m(b)(2)(A) and 78m(b)(2)(B)] and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder [17 C.F.R. 240.12b-20, 240.13a-1, 240.13a-11 and 240.13a-13].

**JURISDICTION AND VENUE**

8. The Commission brings this action to enjoin such acts and practices, for civil penalties, and for other relief, pursuant to Sections 20(b), 20(d) and 20(e) of the Securities Act [15 U.S.C. 77t(b), 77t(d) and 77t(e)], and Sections 21(d), 21(e) and 21A of the Exchange Act [15 U.S.C. 78u(d), 78u(e) and 78u-1].

9. This Court has jurisdiction of this action under Sections 20(b), 20(d), 20(e) and 22(a) of the Securities Act [15 U.S.C. 77t(b), 77t(d), 77t(e) and 77v], and Sections 21(d), 21(e), 21A and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e), 78u-1 and 78aa].

10. Certain of the acts and practices constituting violations of the Securities Act and the Exchange Act have occurred within the Northern District of Georgia and were perpetrated through the use

of the mails and the means and instrumentalities of interstate commerce.

THE DEFENDANTS

11. Gene Ross, of Highlands Ranch, Colorado, was chief executive officer ("CEO") and chairman of the board ("Chairman") of Paragon from January 2, 1989 until his resignation on December 20, 1993. At various times, he also served as Paragon's treasurer, principal financial officer and principal accounting officer.

12. Lynn Ross, of Marietta, Georgia, was president and a director of Paragon from September 1, 1988 until his resignation on December 20, 1993. He is the brother of Gene Ross.

13. Higgins-Hallke, of Smyrna, Georgia, is a certified public accountant who has a masters degree in public accountancy. She became Paragon's chief financial officer on November 1, 1991 and resigned from Paragon on March 15, 1994. At various times, she also served as Paragon's vice president-finance, treasurer, and principal accounting officer.

ENTITY INVOLVED

14. Paragon was a mortgage banking firm headquartered in Smyrna, Georgia. It was incorporated in Illinois on May 27, 1988, commenced operations in September 1988, conducted its initial public offering ("IPO") on August 8, 1989, and was dissolved on October 1, 1994. Paragon's operations included originating residential real estate loans and selling the resulting mortgage secured notes in the secondary mortgage market, brokering mortgage loans and servicing mortgage loans. Paragon's common stock was

registered pursuant to Section 12(g) of the Exchange Act [15 U.S.C. 781(g)]. From March 1990 until August 1, 1991, the common stock was traded over-the-counter and listed in the pink sheets published by the National Quotation Bureau. From August 2, 1991 until October 27, 1994, the common stock was traded on the NASDAQ Stock Market System ("NASDAQ").

**PARAGON'S FALSE AND MISLEADING REPORTS,  
REGISTRATION STATEMENTS AND PROXY STATEMENTS**

15. On or about August 13, 1990, Paragon filed with the Commission a quarterly report on Form 10-Q for the quarter ended June 30, 1990 (the "June 1990 10-Q"). The June 1990 10-Q included Paragon's financial statements for the three month and nine month periods ended June 30, 1990.

16. Gene Ross participated in the preparation of the June 1990 10-Q and signed the report in his capacity as Chairman and Principal Executive Officer of Paragon.

17. On or about January 11, 1991, Paragon filed with the Commission an annual report on Form 10-K for the year ended September 30, 1990 (the "1990 10-K"). The 1990 10-K included Paragon's financial statements for the years ended September 30, 1989 and 1990.

18. Gene Ross participated in the preparation of the 1990 10-K and signed the report in his capacity as Chairman, principal executive officer, treasurer, principal financial officer and principal accounting officer of Paragon.

19. Lynn Ross participated in the preparation of the 1990 10-K and signed the report in his capacity as president and a director of Paragon.

20. On or about February 28, 1991, Paragon filed with the Commission a registration statement on Form S-1 (the "1991 S-1"). The 1991 S-1 became effective on July 3, 1991. The 1991 S-1 included Paragon's financial statements for the years ended September 30, 1989 and 1990, the three month and six month periods ended March 31, 1990, and the three month and six month periods ended March 31, 1991.

21. Gene Ross participated in the preparation of the 1991 S-1 and signed the 1991 S-1 in his capacity as Chairman, principal executive officer, treasurer, principal financial officer and principal accounting officer of Paragon.

22. Lynn Ross participated in the preparation of the 1991 S-1 and signed the 1991 S-1 in his capacity as president and a director of Paragon.

23. On or about January 14, 1992, Paragon filed with the Commission an annual report on Form 10-K for the year ended September 30, 1991 (the "1991 10-K"). The 1991 10-K included Paragon's financial statements for the years ended September 30, 1989, 1990 and 1991.

24. Gene Ross participated in the preparation of the 1991 10-K and signed the report in his capacity as Chairman, principal executive officer, and treasurer of Paragon.

25. Lynn Ross participated in the preparation of the 1991 10-K and signed the report in his capacity as president and a director of Paragon.

26. On or about January 29, 1992, Paragon filed with the Commission a registration statement on Form S-1 (the "1992 S-1"). The 1992 S-1 became effective on April 27, 1992. The 1992 S-1 included Paragon's financial statements for the years ended September 30, 1989, 1990 and 1991.

27. Gene Ross participated in the preparation of the 1992 S-1 and signed the 1992 S-1 in his capacity as Chairman, principal executive officer and treasurer of Paragon.

28. Lynn Ross participated in the preparation of the 1992 S-1 and signed the 1992 S-1 in his capacity as president and a director of Paragon.

29. On or about June 1, 1992, Paragon filed with the Commission a proxy statement for its 1992 annual meeting of shareholders (the "1992 Proxy"). The 1992 Proxy solicited shareholder votes for the re-election of the Ross brothers to the board of directors.

30. Gene Ross and Lynn Ross participated in the preparation of the 1992 Proxy, permitted their names to be used in the 1992 Proxy, and authorized the 1992 Proxy's distribution by mail to Paragon shareholders.

31. On or about January 12, 1993, Paragon filed with the Commission an annual report on Form 10-K for the year ended September 30, 1992 (the "1992 10-K"). The 1992 10-K included

Paragon's financial statements for the years ended September 30, 1990, 1991 and 1992.

32. Gene Ross participated in the preparation of the 1992 10-K and signed the report in his capacity as Chairman and principal executive officer of Paragon.

33. Lynn Ross participated in the preparation of the 1992 10-K and signed the report in his capacity as president and a director of Paragon.

34. Higgins-Hallke participated in the preparation of the 1992 10-K and signed the report in her capacity as vice president-finance, treasurer, principal financial officer and principal accounting officer of Paragon.

35. On or about February 22, 1993, Paragon filed with the Commission a quarterly report on Form 10-Q for the quarter ended December 31, 1992 (the "December 1992 10-Q"). The December 1992 10-Q included Paragon's financial statements for the three month period ended December 31, 1992.

36. Gene Ross participated in the preparation of the December 1992 10-Q and signed the report in his capacity as Chairman and principal executive officer of Paragon.

37. Higgins-Hallke participated in the preparation of the December 1992 10-Q and signed the report in her capacity as vice president-finance, principal financial officer and treasurer of Paragon.

38. On or about February 26, 1993, Paragon filed with the Commission a registration statement on Form S-1 (the "1993 S-1").

The 1993 S-1 became effective on March 26, 1993. The 1993 S-1 included Paragon's financial statements for the years ended September 30, 1990, 1991 and 1992, and the three month periods ended December 31, 1991 and December 31, 1992.

39. Gene Ross participated in the preparation of the 1993 S-1 and signed the 1993 S-1 in his capacity as Chairman and principal executive officer of Paragon.

40. Lynn Ross participated in the preparation of the 1993 S-1 and signed the 1993 S-1 in his capacity as president and a director of Paragon.

41. Higgins-Hallke participated in the preparation of the 1993 S-1 and signed the 1993 S-1 in her capacity as vice president-finance, principal financial officer and principal accounting officer of Paragon.

42. On or about April 10, 1993, Paragon filed with the Commission a proxy statement for its 1993 annual meeting of shareholders (the "1993 Proxy"). The 1993 Proxy solicited shareholder votes for the re-election of the Ross brothers to the board of directors.

43. Gene Ross and Lynn Ross participated in the preparation of the 1993 Proxy, permitted their names to be used in the 1993 Proxy, and authorized the 1993 Proxy's distribution by mail to Paragon shareholders.

44. On or about May 25, 1993, Paragon filed with the Commission a current report on Form 8-K for the period May 18, 1993

(the "1993 8-K"). The 1993 8-K reported a change in Paragon's independent accountants.

45. Gene Ross authorized the filing of the 1993 8-K with the Commission.

46. Higgins-Hallke participated in the preparation of the 1993 8-K and signed the report in her capacity as vice president-finance, principal financial officer and treasurer of Paragon.

47. On or about June 8, 1993, Paragon filed with the Commission an amendment to the current report on Form 8-K for the period May 18, 1993 (the "1993 8-K amendment").

48. Gene Ross was aware that the 1993 8-K amendment was filed with the Commission.

49. Higgins-Hallke participated in the preparation of the 1993 8-K amendment and signed the report in her capacity as vice president-finance, principal financial officer and treasurer of Paragon.

50. On or about February 28, 1994, Paragon filed with the Commission an annual report on Form 10-K for the year ended September 30, 1993 (the "1993 10-K"). The 1993 10-K included Paragon's financial statements for the years ended September 30, 1991, 1992 and 1993.

#### MISREPRESENTATIONS AND OMISSIONS

##### MISAPPROPRIATION OF FUNDS

51. In October 1988, the Ross brothers obtained a personal \$350,000 one-year loan (the "joint loan") from Plano Bank and Trust Company ("Plano") of Plano, Texas. The proceeds of the loan were

used by Lynn Ross to capitalize and retain all of the common shares of Paragon.

52. On January 2, 1989, Gene Ross joined Paragon as CEO and Chairman. At that time, Lynn Ross distributed shares of Paragon stock to Gene Ross in accordance with a purported prearranged agreement between them.

53. In October 1989, the joint loan was renewed for \$347,000 using the Paragon stock holdings of the Ross brothers as collateral for the loan.

54. During the five year period ended September 30, 1993, the Ross brothers, singly or in concert, diverted and used \$229,040 of Paragon corporate funds to pay principal and interest on the joint loan and on three other personal loans, including \$8,879 during the year ended September 30, 1989; \$50,111 during the year ended September 30, 1990; \$70,719 during the year ended September 30, 1991; \$40,670 during the year ended September 30, 1992; and \$58,661 during the year ended September 30, 1993. Specifically, between 1989 and 1993, the Ross brothers misappropriated \$141,033 from Paragon by directing Paragon to use corporate funds to make principal and interest payments to banks for their personal benefit. In addition, during 1992 and 1993, the Ross brothers misappropriated \$88,007 by personally intercepting production bonus checks, which had been remitted to Paragon by outside parties, and diverting those checks to repay personal loans.

55. During 1992 and 1993, Paragon earned the production bonus checks based upon the number and dollar amount of loans it sold to

third parties. The checks were made payable, and sent directly, to Paragon where they were intercepted by Lynn Ross, with Gene Ross's knowledge. Gene Ross and Lynn Ross each endorsed checks directly to banks to repay personal loans.

56. The use of corporate funds to repay personal loan obligations began approximately three weeks before Paragon's IPO was declared effective by the Commission in 1989 and continued during 1993. Such use of corporate funds was never disclosed in filings made by Paragon with the Commission from 1989 through 1993. During this time, Paragon filed with the Commission its IPO on Form S-18, its annual report on Form 10-K for the year ended September 30, 1989, the 1990 10-K, 1991 10-K, 1992 10-K, 1991 S-1, 1992 S-1, 1993 S-1, 1992 Proxy and 1993 Proxy.

57. Paragon's 1990 through 1992 financial statements failed to disclose the ongoing practice pursuant to which Paragon was repaying the \$347,000 personal joint loan to Plano on behalf of the Ross brothers, and the dollar amount of payments made by Paragon to personally benefit the Ross brothers. These disclosures were required to be made in the notes to the 1990, 1991 and 1992 financial statements in accordance with generally accepted accounting principles ("GAAP") and Regulation S-X [17 C.F.R. 210].

58. Paragon's 1992 financial statements failed to disclose the amount and fact that Paragon was repaying a personal loan at First of America Bank of Illinois ("First of America") to benefit the Ross brothers during 1992 as required to be disclosed in the

notes to the 1992 financial statements in accordance with GAAP and Regulation S-X [17 C.F.R. 210].

59. The 1992 and 1993 Proxies disclosed certain loans previously made by the Ross brothers to Paragon dating back to 1989, and disclosed the personal Paragon stock holdings of the Ross brothers. However, these disclosures were misleading because they failed to disclose the related party transactions between the Ross brothers, Plano and First of America from 1990 through the date of each proxy. Such disclosure would have shown the true method of how the Ross brothers obtained their stock holdings, i.e., by using misappropriated corporate funds.

60. Gene Ross and Lynn Ross knowingly, intentionally and/or with severe recklessness, omitted and caused Paragon to omit, material disclosures regarding the above described related party transactions between the Ross brothers, Paragon, Plano and First of America and the use of corporate funds to repay personal loan obligations from Paragon's 1990 10-K, 1991 10-K, 1992 10-K, 1991 S-1, 1992 S-1, 1993 S-1, 1992 Proxy and 1993 Proxy.

**FAILURE TO RECORD AND REPORT  
STOCK COMPENSATION EXPENSE**

61. On June 22, 1990, Paragon's board of directors, including the Ross brothers, granted stock options to themselves and four other employees to purchase 530,000 shares of Paragon's common stock. The grant was made in consideration for past services provided by each individual to Paragon. The options were immediately exercisable.

62. On June 22, 1990, the exercise price of the options was less than the market value of the stock. The difference between the exercise and market prices multiplied by the number of shares to which the options were applicable (530,000) was \$258,750.

63. The \$258,750 should have been fully reported by Paragon as compensation expense in the June 1990 10-Q and 1990 10-K financial statements in accordance with GAAP and Regulation S-X.

64. Gene Ross, who at the time was acting as Paragon's principal accounting officer, failed to record and report the \$258,750 of compensation expense on Paragon's books and in its financial statements.

65. Gene Ross was fully aware of the stock options as he had proposed granting the options at the June 22, 1990 board meeting, and he also had signed the board minutes which authorized the granting of the options.

66. Further, the terms of the stock options granted on June 22, 1990 were not disclosed in Paragon's 1990 annual financial statements as required by GAAP.

67. Gene Ross failed to report the \$258,750 of compensation expense in Paragon's financial statements as required by GAAP and Regulation S-X, resulting in Paragon's income being materially overstated in the June 1990 10-Q, 1990 10-K, 1991 S-1 and 1992 S-1.

68. Gene Ross omitted material disclosures regarding \$258,750 of stock compensation expense from the June 1990 10-Q, 1990 10-K, 1991 S-1 and 1992 S-1, including disclosures of the number of

shares under option, the option price and the number of shares as to which options were exercisable.

**FAILURE TO RECORD AND REPORT  
OTHER COMPENSATION EXPENSE**

69. Paragon's 1990 financial statements, included in Paragon's 1990 Form 10-K and 1991 Form S-1 registration statement, both of which were filed with the Commission, failed to report \$200,000 of compensation expense incurred by Paragon during 1990. As a result, Paragon's reported income and stockholders' equity for 1990 was materially overstated.

70. The additional \$200,000 of compensation expense had been recorded in Paragon's books, and had been certified by Paragon's independent accountants. However, after Gene Ross received the 1990 audited financial statements from Paragon's independent accountants, he altered those financial statements by deleting \$200,000 of compensation expense from the 1990 financial statements which were filed with the Commission.

71. In addition, Gene Ross altered the 1990 audited financial statements by increasing the amount of recorded assets, and by decreasing the amount of recorded liabilities, by \$200,000.

72. As a result of Gene Ross's actions, the difference between Paragon's reported total assets and total liabilities (i.e., net worth) was inconsistent with the reported value of Paragon's net worth. Further, the reported amount of liabilities was inconsistent with the amount reported in the note to the financial statements concerning audited liabilities.

73. Previously, on December 12, 1990, Gene Ross signed Paragon's management representation letter which was provided to Paragon's independent accountants. This letter stated, among other things, that Gene Ross was solely responsible for ensuring that Paragon's 1990 financial statements conformed with GAAP. .

74. Gene Ross falsified Paragon's financial condition, stockholders' equity, and results of operations because of Paragon's then pending application to obtain listing on the NASDAQ, and because the value of Gene Ross's Paragon stock, which was being held as collateral by Plano for two personal loans, would be enhanced by a NASDAQ listing.

75. The failure to record the \$200,000 of compensation expense was not disclosed to the public until Paragon issued a press release on December 13, 1991.

76. Gene Ross knowingly, intentionally and/or with severe recklessness, failed to report and caused Paragon to fail to report the \$200,000 of compensation expense, a material amount, in Paragon's 1990 financial statements as required by GAAP, resulting in Paragon's income and stockholders' equity being materially overstated in the 1990 10-K and 1991 S-1.

**IMPROPER RECORDING AND REPORTING  
OF GAINS FROM THE SALES OF LOANS**

77. On October 21, 1991, Paragon acquired All Georgia Mortgage Company with the intention of building a large loan servicing portfolio and retaining servicing for the long-term.

78. Subsequently, Paragon began to purchase mortgage loans with the intention of subsequently selling the loans and retaining

the servicing rights (i.e., Paragon would continue to service the loans after they were sold to a third party).

79. During 1992, Paragon recognized \$814,949 of gains from the sale of purchased loans in violation of GAAP, in that Paragon recognized gains from the sale of the purchased loans without first offsetting the gains against the carried value of the purchase mortgage servicing right.

80. Gene Ross and Higgins-Hallke were both told by Daniel C. Langford, Jr. and Peter P. Irby, two audit managers of Paragon's independent accountants, Langford de Kock & Company, early during the 1992 audit of Paragon's financial statements, that Paragon's recognition of the gains violated GAAP. Audit partners Daniel C. Langford and Stephanus A. de Kock told Gene Ross and Higgins-Hallke that representatives of the American Institute of Certified Public Accountants and the Financial Accounting Standards Board had advised the accountants of that fact. However, Gene Ross and Higgins-Hallke chose to ignore this information and evidence of the GAAP violation, and failed to properly apply GAAP to record the sales of the loans.

81. During 1993, Paragon's financial statements were misstated because of the recognition \$226,484 of gains from the sale of purchased loans in violation of GAAP.

82. The \$226,484 of misstatements during 1993 resulted from Paragon's lack of detailed records, which prevented it from determining the proper amount of gains to be reported during 1993.

83. Higgins-Hallke signed Paragon's 1993 management representation letter, dated February 7, 1994, which was provided to Paragon's independent accountants. This letter stated, among other things, that Paragon's 1993 financial statements were presented in conformity with GAAP and that Higgins-Hallke and others were responsible for establishing and maintaining an internal control structure during 1993.

84. Higgins-Hallke failed to ensure that Paragon had adequate internal accounting controls to allow its books and records to capture and properly record gains from the sales of loans during 1993.

85. Gene Ross knowingly, intentionally and/or with severe recklessness, recorded and reported, and caused Paragon to record and report, \$814,949 of gains from the sale of such purchased loans in Paragon's books and in its financial statements for the year ended September 30, 1992 in violation of GAAP. As a result, Paragon's income before income taxes and extraordinary item was materially overstated in Paragon's books, and in its 1992 10-K and 1993 S-1.

86. Higgins-Hallke knowingly, intentionally and/or with severe recklessness, recorded and reported, and caused Paragon to record and report, \$814,949 of gains from the sale of such purchased loans in Paragon's books and in its financial statements for the year ended September 30, 1992 in violation of GAAP. As a result, Paragon's income before income taxes and extraordinary item

was materially overstated in Paragon's books, and in its 1992 10-K and 1993 S-1.

87. Higgins-Hallke knowingly, intentionally and/or with severe recklessness, recorded and reported, and caused Paragon to record and report, \$226,484 of gains from the sale of such purchased loans in Paragon's books and in its financial statements for the year ended September 30, 1993 in violation of GAAP. As a result, Paragon's net loss was materially understated in Paragon's books, and in its 1993 10-K.

**FAILURE TO REPORT SELF-INSURED MEDICAL EXPENSES**

88. During the year ended September 30, 1992, Paragon instituted a self-insured employee medical plan. Under that plan, Higgins-Hallke received a monthly report listing medical claims owed by Paragon.

89. Through these monthly reports, Higgins-Hallke knew that Paragon had incurred \$24,961 of claims under the plan during the year ended September 30, 1992.

90. These claims should have been recognized as an expense in accordance with GAAP. Nonetheless, in its 1992 financial statements, Paragon, through Higgins-Hallke, failed to accrue and report the \$24,961 of medical claims that were incurred during 1992.

91. Higgins-Hallke knowingly, intentionally and/or with severe recklessness, failed to record and report, and caused Paragon to fail to record and report, \$24,961 of self-insured medical expenses in Paragon's books and in its financial statements

in violation of GAAP. As a result, Paragon's income before income taxes and extraordinary item was materially overstated in Paragon's books, and in its 1992 10-K and 1993 S-1.

**IMPROPER RECORDING AND REPORTING OF GAIN  
FROM THE SALE OF MORTGAGE LOAN SERVICING RIGHTS**

92. During the latter part of 1992, Paragon, through Gene Ross and other Paragon representatives, was in preliminary negotiations to sell certain mortgage loan servicing rights to an unrelated third party.

93. Higgins-Hallke was aware of the negotiations and had a copy of the proposed sales agreement.

94. Higgins-Hallke called Paragon's independent accountants, Langford de Kock & Company, on December 23, 1992. Langford de Kock & Company had been engaged by Paragon to review, but not issue any reports or opinions on, the December 1992 10-Q.

95. Higgins-Hallke asked Langford de Kock & Company whether the proposed sale of mortgage loan servicing rights could be recorded in Paragon's books as of December 31, 1992.

96. On January 7, 1993, Langford de Kock & Company told Gene Ross that the gain from the sale of the mortgage loan servicing rights should not be reported until the quarter ended March 31, 1993, by which time the closing of the sale would have occurred.

97. Subsequently, Langford de Kock & Company informed Higgins-Hallke that they had told Gene Ross that the sale of the mortgage loan servicing rights should not be reported at December 31, 1992.

98. The sale of the mortgage loan servicing rights was approved by Paragon's board of directors, including Gene Ross, on February 1, 1993.

99. In a letter dated February 4, 1993 to Gene Ross, Langford de Kock & Company reiterated that this transaction should not be recorded at December 31, 1992, and represented that they would have required Paragon to restate its financial statements had they been auditing the financial statements in question.

100. On February 16, 1993, Higgins-Hallke filed a report on Form 12b-25 with the Commission to notify the public that the December 1992 10-Q would be filed late because the sale of the mortgage loan servicing rights occurred on December 31, 1992, thereby requiring additional time for Paragon to properly disclose the transaction in the December 1992 10-Q.

101. The closing for the sale did not occur until after February 25, 1993 when title and consideration were exchanged.

102. Gene Ross directed that the \$260,305 gain be recorded in Paragon's books and reported in the December 1992 10-Q, even though the closing date for the transaction was after February 25, 1993; and he did so after Langford de Kock & Company had told him that the gain could not be recognized until the quarter ended March 31, 1993.

103. Higgins-Hallke directed that the \$260,305 gain be recorded in Paragon's books and reported in the December 1992 10-Q, even though the closing date for the transaction was after February 25, 1993; and she did so after Langford de Kock & Company had told

her that the gain could not be recognized until the quarter ended March 31, 1993.

104. As a result, Paragon prematurely recorded in its books and reported a \$260,305 gain from this transaction in the December 1992 10-Q.

105. Gene Ross knowingly, intentionally and/or with severe recklessness, recorded and reported, and caused Paqragon to record and report, \$260,305 of gain from the sale of mortgage loan servicing rights in Paragon's books and in its financial statements in violation of GAAP. As a result, Paragon's income before income taxes and extraordinary item was materially overstated in Paragon's books, and in its December 1992 10-Q and 1993 S-1.

106. Higgins-Hallke knowingly, intentionally and/or with severe recklessness, recorded and reported, and caused Paragon to record and report, \$260,305 of gain from the sale of mortgage loan servicing rights in Paragon's books and in its financial statements in violation of GAAP. As a result, Paragon's income before income taxes and extraordinary item was materially overstated in Paragon's books, and in its December 1992 10-Q and 1993 S-1.

**FAILURE TO REPORT A DISAGREEMENT  
WITH THE INDEPENDENT ACCOUNTANTS**

107. On May 18, 1993, Paragon replaced Langford de Kock & Company as its independent accountants.

108. On May 25, 1993, Paragon filed the 1993 8-K to report a change in its independent accountants. The 1993 8-K reported that Paragon and Langford de Kock & Company had had no disagreements during any interim period subsequent to September 30, 1992.

109. On June 8, 1993, Paragon filed the 1993 8-K amendment which included a letter from Langford de Kock & Company confirming that there had been no disagreements between it and Paragon.

110. The 1993 8-K and 1993 8-K amendment were false and misleading because, as discussed above in paragraphs 92-106, Langford de Kock & Company had disagreed with Paragon's recognition of income from the sale of mortgage loan servicing rights at December 31, 1992.

111. Paragon was required to disclose the disagreement in the 1993 8-K and 1993 8-K amendment pursuant to Item 4(a) of Form 8-K and Items 304(a)(1)(iv) and 304(a)(3) of Regulation S-K [17 C.F.R. 229.304], and Section 603.06 of the Commission's Codification of Financial Reporting Policies.

112. Gene Ross and Higgins-Hallke were personally involved in, and aware of, the disagreement with Langford de Kock & Company regarding the reporting of the gain from the sale of mortgage loan servicing rights at December 31, 1992.

113. Gene Ross and Higgins-Hallke were responsible for Paragon's reporting of the disagreement between Paragon and its independent accountants. They knowingly, intentionally and/or with severe recklessness, caused Paragon to file a materially false and misleading report on the 1993 Form 8-K and the amendment thereto, when they failed to disclose a disagreement between Paragon and its independent accountants.

### ILLEGAL INSIDER TRADING

114. On December 31, 1990, Gene Ross made an application with the National Association of Securities Dealers, Inc. ("NASD") to have Paragon's common stock listed on the NASDAQ.

115. On February 4, 1991, the NASD denied Paragon's listing application due to insufficient stockholders' equity

116. On June 21, 1991, the NASD held a hearing to afford Paragon an appeal of their listing denial. During the hearing, Gene Ross emphasized the numerical value of Paragon's stockholders' equity as disclosed in Paragon's reports on Form 10-Q for the quarters ended June 30, 1990, December 31, 1990 and March 31, 1991, and in the 1990 10-K. However, each of these reports was false and misleading because the reported net loss and/or stockholders' equity were materially misstated because of Paragon's failure to report \$458,750 of compensation expense as discussed above in paragraphs 61 through 76.

117. On August 2, 1991, Paragon's stock was listed on the NASDAQ and simultaneously placed on the NASDAQ's "Monitor List."

118. On August 28, 1991, Gene Ross notified his bank that Paragon's stock was listed on the NASDAQ, thereby enhancing the value of his Paragon stock, which he had previously pledged as collateral to secure two personal loans. He also provided the bank with a copy of Paragon's report on Form 10-Q for the quarter ended June 30, 1991. This 10-Q was false and misleading because it materially overstated stockholders' equity by the same \$458,750.

119. On September 1, 1991, Gene Ross was allowed by his bank to renew his two personal loans using his Paragon stock as collateral.

120. From August 2, 1991 through October 27, 1994, Paragon's common stock traded on the NASDAQ.

121. On or about June 30, 1993, Gene Ross directed Higgins-Hallke to begin an internal investigation to determine whether Paragon was receiving all revenues it was due from third parties to whom it sold loans. Gene Ross directed Higgins-Hallke to three such third parties and advised her how to conduct the investigation.

122. Gene Ross knew, when he instructed Higgins-Hallke to conduct the investigation, that she would discover a diversion of production bonus checks by the Ross brothers.

123. On or about September 23, 1993, Higgins-Hallke informed Gene Ross that Lynn Ross had improperly endorsed three checks, which had been made payable to Paragon by third parties, to Plano.

124. On or about October 8, 1993, Higgins-Hallke told Gene Ross that Paragon's accounting department had been researching past due accounts receivable from third parties, and was discovering that the receivable balances were incorrect or had previously been paid. Higgins-Hallke also told Gene Ross that Lynn Ross would be questioned about the discrepancies in the balances.

125. Between September 9, and October 8, 1993, Gene Ross personally sold 33,500 shares of Paragon common stock while he was in possession of adverse, material, nonpublic information.

Specifically, Gene Ross sold 3,000 shares at \$1.50 per share on September 9, 1993, 13,500 shares at \$1.5625 per share and 2,500 shares at \$1.625 per share on October 7, 1993, and 14,500 shares at \$1.585 per share on October 8, 1993. On each of these dates, Gene Ross was aware of inaccurate public reports which had been filed by Paragon and of the status of the internal, nonpublic investigation being conducted by Higgins-Hallke, and he knew that the results of that investigation would show that the Ross brothers, the two top officers of Paragon, had diverted money from Paragon.

126. In late October 1993, Higgins-Hallke discovered that Gene Ross had also diverted production bonus checks.

127. In November 1993, Higgins-Hallke told Paragon's then independent accountants, Ernst & Young LLP ("Ernst & Young"), that the Ross brothers had been diverting production bonus checks for personal use. She also told Ernst & Young about certain October 1992 and June 1993 diversions of funds by Lynn Ross.

128. Previously, in October 1992 and in June 1993, Lynn Ross improperly deposited a \$4,351 check and a \$11,250 check, respectively, into his personal checking account. Both checks had originally been made payable to Paragon. The latter check was used by Lynn Ross to pay personal expenses related to his pool. After becoming aware of these diversions, Paragon demanded, and received, reimbursement of these funds from Lynn Ross.

129. On November 15, 1993, at the insistence of Ernst & Young, Paragon engaged special outside counsel to perform an

independent investigation into the conduct of the Ross brothers relating to their alleged misappropriation of funds.

130. In approximately early December 1993, Gene Ross told his wife, Leigh McBride Ross, to conduct a meeting at their house with Gene Ross' two adult sons, Craig A. Ross and Cayle A. Ross, and Leigh McBride Ross' brother, D. David McBride. At the meeting, Leigh McBride Ross, on Gene Ross' instructions, told these three family members, who were employees of Paragon and whom Gene Ross knew held stock of Paragon, about the fraudulent misconduct of the Ross brothers being alleged by the external investigators, and stated that the Ross brothers would be removed from their positions as officers of Paragon. Gene Ross knew that this information was confidential and nonpublic, and that the communication of this information by Gene Ross to his family was prohibited by Paragon's corporate insider trading policies.

131. Subsequently, during the period of December 8, 1993 through December 17, 1993, Gene Ross' two adult sons and brother-in-law sold, while in possession of the material nonpublic information discussed at the family meeting, a total of 8,000 shares of Paragon stock.

132. At a special board meeting held on December 20, 1993, convened to discuss the Ross brothers' fraudulent conduct and the findings of the investigation conducted by Paragon's special outside counsel, the Ross brothers resigned from Paragon.

133. At 3:46 p.m. on December 21, 1993, Paragon's stock was halted from trading on the NASDAQ, closing at \$2 per share.

134. After the NASDAQ closed on December 21, 1993, Paragon issued a press release and, for the first time, publicly disclosed, among other things, that the Ross brothers had resigned from Paragon; that the Ross brothers had misappropriated Paragon funds to repay personal loans during the years 1989 through 1993; that Ernst & Young would not be able to render an unqualified opinion on Paragon's financial statements for the year ended September 30, 1993 because they did not believe that they could rely on representations of Paragon's former management (i.e., the Ross brothers) in conducting their audit; that it was likely that Paragon's financial statements for the year ended September 30, 1992 would be restated to substantially reduce previously reported pre-tax and net earnings; and that as a result of these matters, it was unlikely that Paragon would proceed with a previously announced proposed acquisition of a privately-held mortgage servicing company, and Paragon was unsure of the impact these matters would have on its mortgage lending business and the approvals obtained to conduct that business.

135. Paragon's stock did not resume trading on NASDAQ until December 23, 1993. On December 23, 1993, Paragon's stock traded as low as \$ .75 per share, down 63% from the previous closing price, before closing at \$1.25 per share, down approximately 40% from the previous closing price.

136. By selling his Paragon stock before the fraudulent conduct and resignation of the Ross brothers, and its related

effects, were publicly disclosed, Gene Ross personally avoided losses of \$10,764.

137. As a result of Gene Ross's tipping of material, nonpublic information to his family members, the three members of his family avoided losses totalling \$7,500.

138. Gene Ross knowingly, intentionally and/or with severe recklessness, sold common stock of Paragon while in possession of material, nonpublic information.

139. Gene Ross knowingly, intentionally and/or with severe recklessness, tipped material, nonpublic information to his two adult sons and brother-in-law, each of whom then sold common stock of Paragon.

**PARAGON'S INADEQUATE BOOKS, RECORDS, AND INTERNAL ACCOUNTING CONTROLS, AND RELATED VIOLATIONS BY GENE ROSS, LYNN ROSS AND HIGGINS-HALLKE**

140. From 1989 through 1994, Paragon was required to make and keep books, records, and accounts, which in reasonable detail, accurately and fairly reflected transactions and dispositions of its assets.

141. From 1989 through 1994, Paragon was required to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that: (a) transactions were executed in accordance with management's general or specific authorization, (b) transactions were recorded as necessary (i) to permit preparation of financial statements in conformity with GAAP or any other criteria applicable to such statements, and (ii) to maintain accountability for assets, (d) access to its assets was permitted

only in accordance with management's general or specific authorization, and (e) the recorded accountability for its assets was compared with its existing assets at reasonable intervals and appropriate action was taken with respect to any differences.

142. Paragon's books, records, and accounts failed to reflect the true nature of \$141,033 of payments made by it to various banks to benefit the Ross brothers during the period 1989 through 1993, as described in paragraph 54, above. Additionally, Paragon's internal accounting controls were insufficient, in that Paragon did not have systems in place to record these transactions as necessary to be reported in the financial statements in conformity with GAAP and Regulation S-X.

143. Paragon's books, records, and accounts failed to reflect the receipt and use of production bonus checks in the amount of \$88,007 which were diverted by the Ross brothers during 1992 and 1993, as described in paragraph 54, above. Additionally, Paragon's internal accounting controls were insufficient, in that Paragon did not have systems in place to record these transactions as necessary to be reported in the financial statements in conformity with GAAP and Regulation S-X.

144. Paragon's books, records, and accounts did not reflect the granting of \$258,750 worth of stock options which were granted to certain employees on June 22, 1990, as described in paragraphs 61 and 62, above. Additionally, Paragon's internal accounting controls were insufficient, in that Paragon did not have systems in

place to record this transaction as necessary to be reported in the financial statements in conformity with GAAP and Regulation S-X.

145. Paragon's books, records, and accounts improperly reflected \$814,949 of gains from the sale of certain mortgage loans during the year ended September 30, 1992, as described in paragraphs 77 through 80, above. Additionally, Paragon's internal accounting controls were insufficient in that Paragon did not have systems in place to record these transactions as necessary to be reported in the financial statements in conformity with GAAP.

146. Paragon's books, records, and accounts did not reflect \$24,961 of expenses related to its self-insured employee medical plan during the year ended September 30, 1992, as described in paragraphs 88 through 91, above. Additionally, Paragon's internal accounting controls were insufficient in that Paragon did not have systems in place to record these expenses as necessary to be reported in the financial statements in conformity with GAAP.

147. Paragon's books, records, and accounts improperly reflected \$260,305 of gains from the sale of mortgage loan servicing rights during the quarter ended December 31, 1992, as described in paragraphs 92 through 106, above. Additionally, Paragon's internal accounting controls were insufficient in that Paragon did not have systems in place to record these transactions as necessary to be reported in the financial statements in conformity with GAAP.

148. Paragon's books, records, and accounts improperly reflected \$226,484 of gains from the sale of certain mortgage loans

during the year ended September 30, 1992, as described in paragraphs 81 and 82, above. Additionally, Paragon's internal accounting controls were insufficient in that Paragon did not have systems in place to record these transactions as necessary to be reported in the financial statements in conformity with GAAP.

149. From 1989 through 1993, Gene Ross and Lynn Ross, singly or in concert with others, were responsible for making and keeping Paragon's books, records, and accounts, which, in reasonable detail, accurately and fairly reflected transactions and dispositions of the assets of Paragon, and for devising and maintaining Paragon's internal accounting controls.

150. From 1991 through 1994, Higgins-Hallke, singly or in concert with others, was responsible for making and keeping Paragon's books, records, and accounts, which, in reasonable detail, accurately and fairly reflected transactions and dispositions of the assets of Paragon, and for devising and maintaining Paragon's internal accounting controls.

151. From 1989 through 1993, Gene Ross and Lynn Ross, singly or in concert with others, knowingly circumvented Paragon's internal accounting controls, knowingly failed to implement certain systems of internal accounting controls, and knowingly falsified Paragon's books, records, and accounts.

152. From 1991 through 1994, Higgins-Hallke, singly or in concert with others, knowingly circumvented Paragon's internal accounting controls, knowingly failed to implement certain systems

of internal accounting controls, and knowingly falsified Paragon's books, records, and accounts.

**THE ROSS BROTHERS LIED TO PARAGON'S INDEPENDENT ACCOUNTANTS**

153. On December 12, 1991, the Ross brothers signed the 1991 management representation letter.

154. The 1991 management representation letter falsely stated that there had been no irregularities involving management, and that all material related party transactions had been properly recorded or disclosed in the financial statements for the year ended September 30, 1991. In fact, the Ross brothers' misappropriations, and other compensation described above, had not been recorded or disclosed.

155. The 1991 management representation letter was provided to Langford de Kock & Company, Paragon's then independent accountants, for their use during their 1991 audit of Paragon.

156. On November 13, 1992, the Ross brothers signed the 1992 management representation letter.

157. The 1992 management representation letter falsely stated that there had been no irregularities involving management, and that all material related party transactions had been properly recorded or disclosed in the financial statements for the year ended September 30, 1992. In fact, the Ross brothers' misappropriations had not been recorded or disclosed.

158. The 1992 management representation letter was provided to Langford de Kock & Company, Paragon's then independent accountants, for their use during their 1992 audit of Paragon.

CLAIMS FOR RELIEF

COUNT I

Violations of Section 17(a)(1)  
of the Securities Act [15 U.S.C. 77q(a)(1)]

159. Paragraphs 1 through 158 are hereby realleged and are incorporated herein by reference.

160. Defendants Gene Ross, from 1990 through 1993, defendant Lynn Ross, from 1991 through 1993, and defendant Higgins-Hallke, from 1992 through 1994, singly or in concert, in the offer and sale of securities by the use of means and instruments of transportation and communication in interstate commerce and by the use of the mails, directly and indirectly, employed devices, schemes, and artifices to defraud, all as more particularly described above.

161. The statements and representations alleged herein were known to defendants or recklessly disregarded by them to be materially false and misleading. In making the material representations of fact and material omissions described herein, defendants acted with scienter, that is, with an intent to deceive, manipulate or defraud or with reckless disregard for the truth.

162. By reason of the foregoing, defendants Gene Ross, Lynn Ross, and Higgins-Hallke have violated, and unless restrained and enjoined, will continue to violate Section 17(a)(1) of the Securities Act [15 U.S.C. 77q(a)(1)].

COUNT II

Violations of Sections 17(a)(2) and 17(a)(3)  
of the Securities Act [15 U.S.C. 17q(a)(2) and 77q(a)(3)]

163. Paragraphs 1 through 158 are hereby realleged and are incorporated herein by reference.

164. Defendant Gene Ross, from 1990 through 1993, defendant Lynn Ross, from 1991 through 1993, and defendant Higgins-Hallke, from 1992 through 1994, singly or in concert, in the offer and sale of securities by the use of means and instruments of transportation and communication in interstate commerce and by the use of the mails, directly and indirectly:

- a. obtained money and property by means of untrue statements of material fact and omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and
- b. engaged in transactions, practices, and courses of business which would and did operate as a fraud and deceit upon the purchasers of such securities,

all as more particularly described above.

165. By reason of the foregoing, defendants Gene Ross, Lynn Ross, and Higgins-Hallke have violated, and unless restrained and enjoined, will continue to violate Sections 17(a)(2) and 17(a)(3) of the Securities Act [15 U.S.C. 77q(a)(2) and 77q(a)(3)].

COUNT III

Violations of Section 10(b) of the Exchange Act  
[15 U.S.C. 78j(b)] and Rule 10b-5 thereunder  
[17 C.F.R. 240.10b-5]

166. Paragraphs 1 through 158 are hereby realleged and are incorporated herein by reference.

167. Defendant Gene Ross, from 1990 through 1993, defendant Lynn Ross, from 1991 through 1993, and defendant Higgins-Hallke, from 1992 through 1994, singly or in concert, in connection with the purchase and sale of securities, directly and indirectly, by the use of means and instrumentalities of interstate commerce and by use of the mails:

- a. employed devices, schemes, and artifices to defraud;
- b. made untrue statements of material facts and omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and
- c. engaged in acts, practices, and courses of business which would and did operate as a fraud and deceit upon persons, in connection with the purchase and sale of such securities,

all as more particularly described above.

168. The statements and representations alleged herein were known to defendants or recklessly disregarded by them to be materially false and misleading. In making the material representations of fact and material omissions described herein,

defendants acted with scienter, that is, with an intent to deceive, manipulate or defraud or with reckless disregard for the truth.

169. By reason of the foregoing, defendants Gene Ross, Lynn Ross, and Higgins-Hallke have violated, and unless restrained and enjoined, will continue to violate Section 10(b) of the Exchange Act [15 U.S.C. 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. 240.10b-5].

#### COUNT IV

Liability of Gene Ross, Lynn Ross and Higgins-Hallke, as Control Persons, for Paragon's Violations of Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20 and 13a-1 thereunder [17 C.F.R. 240.12b-20 and 240.13a-1]

170. Paragraphs 1 through 158 are hereby realleged and are incorporated herein by reference.

171. Defendants Gene Ross and Lynn Ross, from 1990 through 1992, prepared, signed and/or filed, singly or in concert, Paragon's 1990 10-K, 1991 10-K and 1992 10-K. Defendant Higgins-Hallke, during 1992 and 1993, prepared, signed and/or filed, singly or in concert, the 1992 10-K and 1993 10-K. The 1990 10-K, 1991 10-K, 1992 10-K and 1993 10-K each were materially false and misleading, as described above.

172. By reason of the foregoing, Paragon violated Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20 and 13a-1 thereunder [17 C.F.R. 240.12b-20 and 240.13a-1].

173. Defendant Gene Ross was the CEO and chairman of the board of directors of Paragon between January 2, 1989 and December 20, 1993. Defendant Lynn Ross was the president and a director of Paragon from September 1, 1988 until December 20, 1993. Defendant

Higgins-Hallke was the chief financial officer of Paragon from November 1, 1991 through March 15, 1994. Gene Ross Lynn Ross and Higgins-Hallke, while associated with Paragon, possessed the power to influence and direct the conduct of Paragon with respect to the activities constituting the violations of Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20 and 13a-1 thereunder [17 C.F.R. 240.12b-20 and 240.13a-1]. In addition, Gene Ross, Lynn Ross and Higgins-Hallke were culpable participants in the conduct.

174. By reason of the foregoing, Gene Ross, Lynn Ross and Higgins-Hallke were controlling persons of Paragon within the meaning of Section 20 of the Exchange Act [15 U.S.C. 78t] and are liable as control persons for Paragon's violations of Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20 and 13a-1 thereunder [17 C.F.R. 240.12b-20 and 240.13a-1].

175. By reason of the foregoing, Gene Ross, Lynn Ross and Higgins-Hallke are liable for violations of, and unless enjoined will continue to violate and cause violations of, Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20 and 13a-1 thereunder [17 C.F.R. 240.12b-20 and 240.13a-1].

#### COUNT V

**Liability of Gene Ross and Higgins-Hallke, as Control Persons, for Paragon's Violations of Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20 and 13a-11 thereunder [17 C.F.R. 240.12b-20 and 240.13a-11]**

176. Paragraphs 1 through 158 are hereby realleged and are incorporated herein by reference.

177. Defendant Higgins-Hallke, during 1993, prepared, signed and/or filed, singly or in concert, the 1993 8-K and 1993 8-K amendment. Gene Ross authorized the filing of the 1993 8-K and 1993 8-K amendment with the Commission. The 1993 8-K and 1993 8-K amendment each were materially false and misleading, as described above.

178. Defendant Gene Ross was the CEO and chairman of the board of directors of Paragon between January 2, 1989 and December 20, 1993. Defendant Higgins-Hallke was the chief financial officer of Paragon from November 1, 1991 through March 15, 1994. Both Gene Ross and Higgins-Hallke, while associated with Paragon, possessed the power to influence and direct the conduct of Paragon with respect to the activities constituting the violations of Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20 and 13a-11 thereunder [17 C.F.R. 240.12b-20 and 240.13a-11]. In addition, both Gene Ross and Higgins-Hallke were culpable participants in the conduct.

179. Gene Ross and Higgins-Hallke were controlling persons of Paragon within the meaning of Section 20 of the Exchange Act [15 U.S.C. 78t] and are liable as control persons for Paragon's violations of Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20 and 13a-11 thereunder [17 C.F.R. 240.12b-20 and 240.13a-11].

180. By reason of the foregoing, defendants Gene Ross and Higgins-Hallke are liable for violations of, and unless restrained and enjoined, will continue to violate and cause violations of,

Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20 and 13a-11 thereunder [17 C.F.R. 240.12b-20 and 240.13a-11].

COUNT VI

**Liability of Gene Ross and Higgins-Hallke, as Control Persons, for Paragon's Violations of Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20 and 13a-13 thereunder [17 C.F.R. 240.12b-20 and 240.13a-13]**

181. Paragraphs 1 through 158 are hereby realleged and are incorporated herein by reference.

182. Defendant Gene Ross, during 1990, prepared, signed and/or filed, singly or in concert, the June 1990 10-Q. Defendants Gene Ross and Higgins-Hallke, during 1992 and 1993, prepared, signed and/or filed, singly or in concert, the December 1992 10-Q. The June 1990 10-Q and December 1992 10-Q each were materially false and misleading, as described above.

183. By reason of the foregoing, Paragon violated Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20 and 13a-13 thereunder [17 C.F.R. 240.12b-20 and 240.13a-13].

184. Defendant Gene Ross was the CEO and chairman of the board of directors of Paragon between January 2, 1989 and December 20, 1993. Defendant Higgins-Hallke was the chief financial officer of Paragon from November 1, 1991 through March 15, 1994. Both Gene Ross and Higgins-Hallke, while associated with Paragon, possessed the power to influence and direct the conduct of Paragon with respect to the activities constituting the violations of Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20 and 13a-13 thereunder [17 C.F.R. 240.12b-20 and 240.13a-13]. In

addition, both Gene Ross and Higgins-Hallke were culpable participants in the conduct.

185. By reason of the foregoing, Gene Ross and Higgins-Hallke were controlling persons of Paragon within the meaning of Section 20 of the Exchange Act [15 U.S.C. 78t] and are liable as control persons for Paragon's violations of Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20 and 13a-13 thereunder [17 C.F.R. 240.12b-20 and 240.13a-13].

186. By reason of the foregoing, defendants Gene Ross and Higgins-Hallke are liable for violations of, and unless restrained and enjoined, will continue to violate and cause violations of Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20 and 13a-13 thereunder [17 C.F.R. 240.12b-20 and 240.13a-13].

#### COUNT VII

Liability of Gene Ross, Lynn Ross and Higgins-Hallke, as Control Persons, for Paragon's Violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. 78m(b)(2)(A) and 78m(b)(2)(B)].

187. Paragraphs 1 through 158 are hereby realleged and are incorporated herein by reference.

188. From 1990 through 1993, Paragon failed, as described above, to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflected transactions and dispositions of its assets.

189. From 1990 through 1993, Paragon failed, as described above, to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that: (a) transactions were executed in accordance with management's general

or specific authorization, (b) transactions were recorded as necessary (i) to permit preparation of financial statements in conformity with GAAP or any other criteria applicable to such statements, and (ii) to maintain accountability for assets, (d) access to its assets was permitted only in accordance with management's general or specific authorization, and (e) the recorded accountability for its assets was compared with its existing assets at reasonable intervals and appropriate action was taken with respect to any differences.

190. By reason of the foregoing, Paragon violated Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. 78m(b)(2)(A) and 78m(b)(2)(B)].

191. Defendant Gene Ross was the CEO and chairman of the board of directors of Paragon between January 2, 1989 and December 20, 1993. Defendant Lynn Ross was the president and a director of Paragon from September 1, 1988 until December 20, 1993. Defendant Higgins-Hallke was the chief financial officer of Paragon from November 1, 1991 through March 15, 1994. Gene Ross, Lynn Ross and Higgins-Hallke, while associated with Paragon, possessed the power to influence and direct the conduct of Paragon with respect to the activities constituting the violations of Section 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. 78m(b)(2)(A) and 78m(b)(2)(B)]. In addition, Gene Ross, Lynn Ross and Higgins-Hallke were culpable participants in the conduct.

192. By reason of the foregoing, Gene Ross, Lynn Ross and Higgins-Hallke were controlling persons of Paragon within the

meaning of Section 20 of the Exchange Act [15 U.S.C. 78t] and are liable as control persons for Paragon's violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. 78m(b)(2)(A) and 78m(b)(2)(B)].

193. By reason of the foregoing, defendants Gene Ross, Lynn Ross and Higgins-Hallke are liable as control persons for violations of, and unless restrained and enjoined, will continue to violate and cause violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. 78m(b)(2)(A) and 78m(b)(2)(B)].

#### COUNT VIII

Violations of Section 13(b)(5) of the Exchange Act [15 U.S.C. 78m(b)(5)] and Rules 13b2-1 and 13b2-2 thereunder [17 C.F.R. 240.13b2-1 and 240.13b2-2]

194. Paragraphs 1 through 158 are hereby realleged and are incorporated herein by reference.

195. Defendant Gene Ross, from 1990 through 1993, and defendant Lynn Ross, from 1991 through 1993, singly or in concert, knowingly circumvented Paragon's internal accounting controls, knowingly failed to implement certain systems of internal accounting controls, knowingly falsified and caused to be falsified Paragon's books, records and accounts, as described in paragraphs 77 through 158 above.

196. During 1992 and 1993, Higgins-Hallke, singly or in concert, knowingly circumvented Paragon's internal accounting

controls, knowingly failed to implement certain systems of internal accounting controls, knowingly falsified and caused to be falsified Paragon's books, records and accounts, as described in paragraphs 77 through 158 above.

197. During 1992 and 1993, Higgins-Hallke, singly or in concert, knowingly falsified Paragon's books, records, and accounts subject to Section 13(b)(2)(A) of the Exchange Act, as described in paragraphs 61 through 158 above.

198. Defendant Gene Ross, from 1990 through 1993, and defendant Lynn Ross, from 1991 through 1993, singly or in concert with others, knowingly falsified Paragon's books, records, and accounts subject to Section 13(b)(2)(A) of the Exchange Act, and:

a. made or caused to be made materially false or misleading statements; and

b. omitted to state, or caused another person to omit to state, material facts necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading, to an accountant in connection with (1) an audit or examination of the financial statements of the issuer required to be made pursuant to Section 13 of the Exchange Act; and (2) the preparation or filing of a document or report required to be filed with the Commission pursuant to this subpart or otherwise, as described in paragraphs 51 through 158 above.

199. Defendant Gene Ross, during 1990, 1991 and 1992, and defendant Lynn Ross, during 1991 and 1992, signed Paragon's

management letters, which were provided to Paragon's independent accountants. Each of these letters contained material untrue statements of facts, as described above.

200. By reason of the foregoing, defendants Gene Ross and Lynn Ross have violated, and unless restrained and enjoined, will continue to violate Section 13(b)(5) of the Exchange Act [15 U.S.C. 78m(b)(5)] and Rules 13b2-1 and 13b2-2 thereunder [17 C.F.R. 240.13b2-1 and 240.13b2-2].

201. By reason of the foregoing, defendant Higgins-Hallke has violated, and unless restrained and enjoined, will continue to violate Section 13(b)(5) of the Exchange Act [15 U.S.C. 78m(b)(5)] and Rule 13b2-1 thereunder [17 C.F.R. 240.13b2-1].

#### COUNT IX

**Violations of Section 14(a) of the Exchange Act  
[15 U.S.C. 78n(a)] and Rule 14a-9 thereunder  
[17 C.F.R. 240.14a-9]**

202. Paragraphs 1 through 158 are hereby realleged and are incorporated herein by reference.

203. Defendants Gene Ross and Lynn Ross participated in the preparation of the 1992 Proxy and 1993 Proxy, and authorized the distribution by mail to Paragon shareholders of the 1992 Proxy and 1993 Proxy. The 1992 Proxy and 1993 Proxy each were materially false and misleading, as described above.

204. Defendants Gene Ross and Lynn Ross during 1992 and 1993, singly or in concert, by the use of means and instrumentalities of interstate commerce and by use of the mails:

- a. solicited proxies and permitted the use of their names to solicit proxies in respect of Paragon common stock; and
- b. made solicitations by means of proxy statements, containing statements which, at the time and in the light of the circumstances under which they were made, were false and misleading with respect to material facts, and which omitted to state material facts necessary in order to make the statements therein not false and misleading,

all as more particularly described above.

205. By reason of the foregoing, defendants Gene Ross and Lynn Ross have violated, and unless restrained and enjoined, will continue to violate Section 14(a) of the Exchange Act [15 U.S.C. 78n(a)] and Rule 14a-9 thereunder [17 C.F.R. 240.14a-9].

**PRAYER FOR RELIEF**

WHEREFORE, Plaintiff Commission, respectfully prays that the Court:

I.

Make findings of fact and conclusions of law in accordance with Rule 52 of the Federal Rules of Civil Procedure.

II.

Issue a permanent injunction enjoining defendant Gene Ross, and his agents, servants, employees, attorneys, and all persons in active concert or participation with him who receive actual notice

of the order by personal service or otherwise, and each of them, from violating:

- a. Section 17(a) of the Securities Act [15 U.S.C. 77q(a)];
- b. Section 10(b) of the Exchange Act [15 U.S.C. 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. 240.10b-5];
- c. Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder [17 C.F.R. 240.12b-20, 240.13a-1, 240.13a-11 and 240.13a-13];
- d. Sections 13(b) (2) (A), 13(b) (2) (B) and 13(b) (5) of the Exchange Act [15 U.S.C. 78m(b) (2) (A), 78m(b) (2) (B) and 78m(b) (5)] and Rules 13b2-1 and 13b2-2 thereunder [17 C.F.R. 240.13b2-1 and 240.13b2-2]; and
- e. Section 14(a) of the Exchange Act [15 U.S.C. 78n(a)] and Rule 14a-9 thereunder [17 C.F.R. 240.14a-9].

### III.

Issue a permanent injunction enjoining defendant Lynn Ross, and his agents, servants, employees, attorneys, and all persons in active concert or participation with him who receive actual notice of the order by personal service or otherwise, and each of them, from violating:

- a. Section 17(a) of the Securities Act [15 U.S.C. 77q(a)];
- b. Section 10(b) of the Exchange Act [15 U.S.C. 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. 240.10b-5];
- c. Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20 and 13a-1 thereunder [17 C.F.R. 240.12b-20 and 240.13a-1];
- d. Sections 13(b) (2) (A), 13(b) (2) (B) and 13(b) (5) of the Exchange Act [15 U.S.C. 78m(b) (2) (A), 78m(b) (2) (B) and 78m(b) (5)] and Rules 13b2-1 and 13b2-2 thereunder [17 C.F.R. 240.13b2-1 and 240.13b2-2]; and
- e. Section 14(a) of the Exchange Act [15 U.S.C. 78n(a)] and Rule 14a-9 thereunder [17 C.F.R. 240.14a-9].

IV.

Issue a permanent injunction enjoining defendant Higgins-Hallke, and her agents, servants, employees, attorneys, and all persons in active concert or participation with her who receive actual notice of the order by personal service or otherwise, and each of them, from violating:

- a. Section 17(a) of the Securities Act [15 U.S.C. 77q(a)];

- b. Section 10(b) of the Exchange Act [15 U.S.C. 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. 240.10b-5];
- c. Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder [17 C.F.R. 240.12b-20, 240.13a-1, 240.13a-11 and 240.13a-13]; and
- d. Sections 13(b) (2) (A), 13(b) (2) (B) and 13(b) (5) of the Exchange Act [15 U.S.C. 78m(b) (2) (A), 78m(b) (2) (B) and 78m(b) (5)] and Rule 13b2-1 thereunder [17 C.F.R. 240.13b2-1].

V.

Issue an Order requiring defendant Gene Ross to disgorge \$18,264, representing losses he and his family avoided when they sold 41,500 shares of Paragon common stock while they were in possession of material, nonpublic information as alleged in the Commission's Complaint, plus prejudgment interest.

VI.

Issue an Order pursuant to Section 21A of the Exchange Act [15 U.S.C. 78u-1] imposing a civil monetary penalty against defendant Gene Ross.

VII.

Issue Orders pursuant to Section 20(d) of the Securities Act [15 U.S.C. 77t(d)] and Section 21(d) (3) of the Exchange Act [15 U.S.C. 78u(d) (3)] imposing civil monetary penalties against

defendants Gene Ross, Lynn Ross and Higgins-Hallke for violations occurring after October 15, 1990.

VIII.

Issue Orders pursuant to Section 20(e) of the Securities Act [15 U.S.C. 77t(e)] and Section 21(d)(2) of the Exchange Act [15 U.S.C. 78u(d)(2)] permanently prohibiting defendants Gene Ross, Lynn Ross, and Higgins-Hallke from acting as an officer or director of any company that has a class of securities registered with the Commission pursuant to Section 12 of the Exchange Act [15 U.S.C. 78l] or that is required to file reports with the Commission pursuant to Section 15(d) of the Exchange Act [15 U.S.C. 78o(d)].

IX.

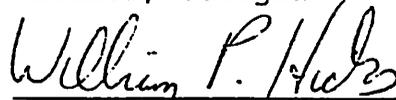
Retain jurisdiction over this action in order to implement and carry out the terms of all orders and decrees that may have been entered or to entertain any suitable application or motion by the Commission for additional relief within the jurisdiction of this Court.

X.

Grant such other and further relief as may be necessary and appropriate.

Dated: Aug. 21, 1997  
Atlanta, Georgia

Respectfully submitted,  
Atlanta, Georgia



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