

**UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS
SHERMAN DIVISION**

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

**1) DIGITAL EXCHANGE SYSTEMS, INC.,
2) ROSARIO CONIGLIO, and
3) STEVEN SCHMIDT,**

Defendants.

**AMENDED
COMPLAINT**

Civil No.: 4:04-CV-324

Plaintiff, the United States Securities and Exchange Commission, files this Complaint against Defendants Digital Exchange Systems, Inc. (“Dexsi”), Rosario Coniglio (“Coniglio”), and Steven Schmidt (“Schmidt”)(collectively, “Defendants”), and would respectfully show the Court as follows:

SUMMARY

1. This case concerns Defendants’ involvement in an illicit income recognition scheme perpetrated by Fleming Companies, Inc. (“Fleming”).

2. Starting in late 2001, Fleming implemented a plan to improperly recognize material amounts of income to compensate for forecasted earnings shortfalls. Dexsi, a Fleming vendor, aided Fleming’s scheme by providing side letters that falsely described two payments, totaling \$6 million to Fleming. When questioned by Fleming’s outside auditors, Dexsi reaffirmed the false information concerning one of the payments. Coniglio, the controlling shareholder of Dexsi, and Schmidt, President of Dexsi, were responsible for dealing with Fleming.

3. Based on the conduct alleged herein, Dexsi, Coniglio, and Schmidt aided and abetted Fleming's violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act [15 U.S.C. §§ 77q(a)(2) and 77q(a)(3)] and Sections 13(a) and 13(b)(2)(A) of the Exchange Act [15 U.S.C. §§ 78m(a) and 78m(b)(2)(A)], and Rules 12b-20, 13a-1, 13a-13 and 13b2-1, thereunder, [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-13 and 240.13b2-1].

JURISDICTION AND VENUE

4. The Commission brings this action pursuant to the authority conferred upon it by Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)], and Sections 21(d)(3) and 27 of the Exchange Act [15 U.S.C. §§ 78u(d)(3) and 78aa].

5. This Court has jurisdiction over this action, and venue is proper, pursuant to Sections 20(d) and 22(a) of the Securities Act [15 U.S.C. §§ 77t(d) and 77v(a)], and Sections 21(d)(3) and 27 of the Exchange Act [15 U.S.C. §§ 78u(d)(3) and 78aa].

6. Defendants, directly or indirectly, have made use of the means and instrumentalities of interstate commerce, or of the mails, or of the facilities of a national exchange in connection with the acts, practices, and courses of action alleged herein.

7. Venue is proper because Fleming is headquartered in Lewisville, Texas, and certain of the acts and transactions described herein took place in the Eastern District of Texas.

DEFENDANTS

8. **Dexsi** is a privately held Delaware corporation based in Tampa, Florida. As a "diverter" within the grocery industry, Dexsi scours the market for special deals, typically buying from other wholesalers, retailers, or inventory liquidators, who have excess inventory of a given product.

9. **Coniglio**, age 47, of North Caldwell, New Jersey, is Dexsi's controlling shareholder and participates in the company's high-level negotiations and business decisions.

10. **Schmidt**, age 35, of Tampa, Florida, is a founder and the president of Dexsi.

OTHER RELEVANT ENTITY

11. **Fleming** is an Oklahoma corporation headquartered in Lewisville, Texas. Fleming's stock is registered pursuant to Section 12 of the Exchange Act and, prior to filing for Chapter 11 bankruptcy protection in April 2003, its stock traded on the New York Stock Exchange. Before bankruptcy, Fleming was the nation's largest grocery wholesaler and a retail grocery operator with approximately 50 distribution centers nationwide and more than 100 retail stores throughout the Midwestern and Western United States. In 2001, Fleming reported approximately \$15.6 billion in revenues and \$23.3 million in profits. In 2002, the company reported \$15.5 billion in revenues and a net loss of \$84 million.

FACTS

Fleming's improper initiatives to meet earnings expectations

12. During 2001 and the first half of 2002, and following a period of poor financial performance, Fleming improperly executed a series of transactions, called "initiatives," to fabricate earnings and "bridge the gap" between actual operating results and Wall Street expectations. In these initiatives, Fleming improperly structured otherwise ordinary transactions in forms that, on paper, would justify and maximize an immediate increase in earnings.

13. One of Fleming's frequently used initiatives was accelerating recognition of up-front payments received under forward-looking vendor agreements. Specifically, Fleming persuaded vendors to provide side letters that described up-front payments—that Fleming and the vendors plainly intended to secure future rights and services—as compensating some form of past performance, such as rebates or expenses. Fleming then used these letters to immediately book the entire up-front payment as an offset to expenses, rather than over time as generally accepted accounting principles (“GAAP”) required.

14. As designed, the illicit reduction in expenses by Fleming significantly inflated the company's earnings in the fourth quarter of 2001 and the first two quarters of 2002 and allowed Fleming to meet securities analysts' earnings expectations.

Dexsi's participation in Fleming's inflated earnings

15. In late 2001, Fleming hired Dexsi to handle part of its diverting business. Fleming was Dexsi's largest customer.

16. In December 2001, Fleming realized that its earnings would fall short of analysts' expectations. To fill some of that shortfall, Fleming turned to Dexsi, demanding a \$2 million payment and a side letter falsely attributing the payment to past performance. Fleming insinuated that, if Dexsi refused, it would terminate their relationship.

17. Knowing that the letter Fleming wanted was false, but recognizing their precarious position, Coniglio and Schmidt acquiesced to Fleming's demands. In return, however, they secured a separate secret agreement from Fleming allowing Dexsi to recoup the \$2 million payment by charging Fleming a higher-than-normal price on

diverting purchases. This mechanism remained in place until February 2002, when Dexsi had recouped the entire \$2 million.

18. The secret agreement was never shown to Fleming's internal accountants or external auditor.

19. The \$2 million up-front payment resulted in an overstatement of Fleming's earnings for the fourth quarter of approximately 15%. Fleming included these misstated earnings in its 2001 Form 10-K and in publicly disseminated press releases.

Dexsi provides Fleming's auditor with a false confirmation letter

20. In February 2002, Fleming's external auditor sent Dexsi a letter requesting confirmation that "Fleming earned a \$2,000,000 rebate for purchases by Fleming from Dexsi in 2001. This rebate is not connected to any future commitments made by Fleming and is not refundable." Although he knew the payment was in fact an advance against future Fleming purchases and had not been entirely earned in 2001, Schmidt signed the confirmation letter and provided it to the auditor.

Dexsi provides Fleming a second misleading side letter

21. In April 2002, for the next fiscal quarter, Fleming again demanded Dexsi's help in filling its earnings shortfall. This time, Fleming demanded that Dexsi pay \$4 million and again insisted that Dexsi provide a side letter mischaracterizing the payment. This time, the side letter provided by Fleming described the advance payment as reimbursement of "warehouse expenses" that Dexsi purportedly incurred during the quarter. In return, Fleming allowed Dexsi to charge higher diverting prices to recoup its payment.

22. Coniglio and Schmidt knew that Dexsi did not owe Fleming payment for warehouse expenses, but still feared that refusal would cost it the Fleming business. In April 2002, Dexsi made the payment and Schmidt signed the false “warehouse expense” letter. Dexsi immediately began charging Fleming the agreed-upon higher price on diverting purchases. Unlike the December payment, Dexsi did not fully recoup the \$4 million because Fleming stopped all diverting business in the summer of 2002.

23. Contrary to GAAP, Fleming relied on Dexsi’s letter to justify recording the \$4 million as an offset to expenses, which equaled nearly 10% of the earnings Fleming reported for the first quarter. Fleming included these misleading figures in its Form 10-Q for the first quarter ended April 20, 2002, and in publicly disseminated press releases. Fleming incorporated the first quarter Form 10-Q into registration statements on Forms S-3, S-8, and S-4 filed with the Commission during the summer of 2002.

FIRST CLAIM

Aiding and Abetting Fleming’s Violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act

(Against Dexsi, Coniglio, and Schmidt)

24. Paragraphs 1 through 23 are realleged and incorporated by reference.

25. Based on the conduct alleged herein, Fleming violated Sections 17(a)(2) and 17(a)(3) of the Securities Act [15 U.S.C. §§ 77q(a)(2) and 77q(a)(3)].

26. Defendants Dexsi, Coniglio, and Schmidt, acting alone or in concert with others, in the manner set forth above, knowingly provided substantial assistance to Fleming in connection with its violations of Sections 17(a)(2) and 17(a)(3) as alleged herein.

27. By reason of the foregoing, Dexsi, Coniglio, and Schmidt aided and abetted Fleming's violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act [15 U.S.C. §§ 77q(a)(2) and 77q(a)(3)].

SECOND CLAIM

Aiding and Abetting Fleming's Violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-1, 13a-13 and 13b2-1 Thereunder

(Against Dexsi, Coniglio, and Schmidt)

28. Paragraphs 1 through 23 are realleged and incorporated by reference.

29. Based on the conduct alleged herein, Fleming violated Sections 13(a) and 13(b)(2)(A) of the Exchange Act [15 U.S.C. §§ 78m(a) and 78m(b)(2)(A)] and Rules 12b-20, 13a-1, 13a-13 and 13b2-1 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-13 and 240.13b2-1].

30. Defendants Dexsi, Coniglio, and Schmidt, acting alone or in concert with others, in the manner set forth above, aided and abetted Fleming, as an issuer of a security registered pursuant to Section 12 of the Exchange Act, in its failing to file with the Commission, in accordance with rules and regulations the Commission has prescribed, information and documents required by the Commission to keep reasonably current the information and documents required to be included in or filed with an application or registration statement filed pursuant to Section 12 of the Exchange Act and annual reports and quarterly reports as the Commission has prescribed.

31. Defendants Dexsi, Coniglio, and Schmidt, acting alone or in concert with others, in the manner set forth above, provided substantial assistance to Fleming, who, directly or indirectly, failed to make and keep books, records, and accounts, which, in

reasonable detail, accurately and fairly reflected Fleming's transactions and dispositions of its assets.

32. By reason of the foregoing, Dexsi, Coniglio, and Schmidt aided and abetted Fleming's violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act [15 U.S.C. §§ 78m(a) and 78m(b)(2)(A)] and Rules 12b-20, 13a-1, 13a-13 and 13b2-1 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-13 and 240.13b2-1].

PRAYER FOR RELIEF

The Commission respectfully requests that the Court:

I.

Enter an order directing Dexsi to pay a \$100,000 civil money penalty pursuant to Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)] and Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)].

II.

Enter an order directing Defendants Coniglio and Schmidt to each pay a \$75,000 civil money penalty pursuant to Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)] and Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)].

III.

Grant such further relief as the Court deems just and proper.

Respectfully submitted,

/s

TIMOTHY P. DAVIS
(Attorney in charge)
Texas Bar No. 00798134

Attorney for Plaintiff
Securities and Exchange Commission
Burnett Plaza, Suite 1900
801 Cherry Street, Unit #18
Fort Worth, TX 76102-6882
(817) 978-6438
(817) 978-4927 (fax)
E-Mail: davistp@sec.gov

Of Counsel:

SPENCER C. BARASCH
D.C. Bar No. 388886
DAVID L. PEAVLER
Texas Bar No. 00784738
JAMES E. ETRI
Texas Bar No. 24002061