

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**  
**Release No. 8483 / September 14, 2004**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 50366 / September 14, 2004**

**ACCOUNTING AND AUDITING ENFORCEMENT**  
**Release No. 2099 / September 14, 2004**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-11654**

_____	:	<b>ORDER INSTITUTING</b>
<b>In the Matter of</b>	:	<b>PROCEEDINGS PURSUANT TO</b>
	:	<b>SECTION 8A OF THE SECURITIES</b>
<b>Digital Exchange Systems,</b>	:	<b>ACT OF 1933 AND SECTION 21C OF</b>
<b>Inc., Rosario Coniglio and</b>	:	<b>THE SECURITIES EXCHANGE ACT</b>
<b>Steven Schmidt,</b>	:	<b>OF 1934, MAKING FINDINGS AND</b>
	:	<b>IMPOSING A CEASE-AND-DESIST</b>
<b>Respondents.</b>	:	<b>ORDER</b>
_____	:	

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate to institute cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 (the “Securities Act”) and Section 21C of the Securities Exchange Act of 1934 (the “Exchange Act”) against Digital Exchange Systems, Inc. (“Dexsi”), Rosario Coniglio (“Coniglio”) and Steven Schmidt (“Schmidt”) (collectively, “Respondents”).

## II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (“Offer”) that the Commission has determined to accept.<sup>1</sup> Solely for the purpose of these proceedings or any other proceeding brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings contained herein, except that Respondents admit the Commission’s jurisdiction over them and over the subject matter of these proceedings, Respondents consent to the entry of this Order Instituting Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings and Imposing a Cease-and-Desist Order.

## III.

On the basis of this Order and Respondents’ Offer, the Commission finds that:<sup>2</sup>

### A. Respondents and Fleming Companies, Inc. (“Fleming”)

#### 1. Respondents

Dexsi is a privately held Delaware corporation based in Tampa, Florida. Rosario Coniglio, age 47, of North Caldwell, New Jersey, is Dexsi’s majority owner. He is not a Dexsi officer or employee but participates in the company’s high-level business decisions. Steven Schmidt, age 35, of Tampa, Florida, is Dexsi’s President and one of its founders.

Dexsi is what is known in the grocery industry as a “diverter.” Diverters scour the market for special deals, typically buying from other wholesale or retail companies, or from inventory liquidators, who have too much inventory of a given product and sell the excess at deep discounts to the manufacturer’s list price. Dexsi buys the inventory at the discount and then sells to its customer (in this case, Fleming) with a small markup, which is still lower than list price. Dexsi’s customer thereby lowers its cost of goods sold, while Dexsi makes money on the markup.

#### 2. Fleming

Fleming is an Oklahoma corporation headquartered in Lewisville, Texas that currently is in Chapter 11 bankruptcy. Before its April 2003 bankruptcy filing, Fleming’s stock traded on the New York Stock Exchange. At one time, Fleming was the nation’s largest grocery wholesaler, with about 50 major distribution centers across the country, and a sizable retail grocery operator as

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<sup>1</sup> Simultaneously with this proceeding, the Commission has filed the following settled actions: In re Fleming Companies, Inc., Exch. Act Rel. No. 34-50365; In re Dean Foods Company and John D. Robinson, Exch. Act Rel. No. 34-50368; In re Kemps LLC f/k/a Marigold Foods, LLC, James Green and Christopher Thorpe, Exch. Act Rel. No. 34-50369; In re Bruce Keith Jensen, Exch. Act Rel. No. 34-50370; and In re John K. Adams, Exch. Act Rel. No. 34-50367.

<sup>2</sup> The findings herein are made pursuant to Respondents’ Offer and are not binding on any other person or entity in these or any other proceedings.

well, with more than 100 stores throughout the Midwest and West. Fleming's 2001 and 2002 reported revenues were approximately \$15.6 billion and \$15.5 billion, respectively. But its earnings relatively were much smaller, with only a \$23.3 million profit and an \$84 million loss, respectively, in those years.

## **B. Facts**

### **1. Fleming uses fraudulent "initiatives" to meet earnings expectations.**

During 2001 and the first half of 2002, Fleming improperly executed a series of transactions, called "initiatives," to fabricate earnings to "bridge the gap" between actual operating results and Wall Street expectations. In these initiatives, Fleming fraudulently structured otherwise ordinary transactions in forms that, on paper, justified and maximized an immediate increase in earnings. One type of initiative that Fleming used frequently during this period was accelerating recognition of up-front payments received under forward-looking vendor agreements. On multiple occasions, Fleming persuaded vendors to provide side letters that described up-front payments – which Fleming and the vendors plainly intended to secure future rights and services – as compensation for some past event, such as a rebate or expense item. Fleming then used these letters to justify recognizing the entire up-front payment as an offset to expenses immediately, rather than over time as generally accepted accounting principles ("GAAP") required. These illicit bookings enabled Fleming to meet securities analysts' earnings expectations. Respondents provided Fleming two such side letters, one in the fourth quarter of 2001 and a second in the first quarter of 2002.

### **2. Dexsi mischaracterizes an up-front payment at Fleming's request.**

In late 2001, Fleming hired Dexsi to handle part of its diverting business. Fleming was, by far, Dexsi's biggest customer. Accordingly, Dexsi expended significant capital ramping up to handle the Fleming business, such as by purchasing equipment and hiring employees to work on-site at Fleming's headquarters.

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. 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 agreement from Fleming allowing Dexsi to recoup the \$2 million by charging Fleming a higher-than-normal price on diverting purchases.<sup>3</sup> This second agreement was never shown to Fleming's internal accountants or external auditor. The parties kept a running tab of Dexsi's recovery of the \$2 million, which Dexsi did not

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<sup>3</sup> To illustrate, if Fleming wanted to purchase a product with a list cost of \$1 per unit, Dexsi normally would sell that product to Fleming for, hypothetically, \$.90. Under their secret agreement, however, Fleming allowed Dexsi to charge \$1 for that product, with the additional \$.10 per unit credited against the \$2 million. This mechanism remained in place until Dexsi recovered the entire \$2 million.

fully recoup until February 2002. The \$2 million overstated Fleming's earnings for the fourth quarter by approximately 15%. Fleming included these misstated earnings in its 2001 Form 10-K, and in publicly disseminated press releases.

**3. Dexsi provides Fleming's auditor with a misleading confirmation letter.**

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 earned in 2001, Schmidt signed the confirmation letter.

**4. Dexsi provides Fleming a second misleading side letter.**

In April 2002, Fleming again demanded Dexsi's help in filling its earnings shortfall for the fiscal first quarter.<sup>4</sup> This time, Fleming demanded that Dexsi pay \$4 million. As before, Fleming insisted that Dexsi provide a side letter describing the payment as reimbursement of "warehouse expenses" that Dexsi purportedly had incurred during the quarter. In return, Fleming allowed Dexsi to charge higher diverting prices to recoup its payment.

Dexsi was loath to pay such a large amount, and knew that it owed Fleming no warehouse expenses, but still feared that refusal would cost it the Fleming business. Therefore, on or about April 10, 2002, Dexsi made the payment and signed the false "warehouse expense" letter. Dexsi immediately began charging Fleming the agreed-upon higher price on diverting purchases, and the parties again tracked Dexsi's recovery of its payment. Unlike the December payment, however, Dexsi does not appear to have fully recouped the \$4 million because Fleming stopped all diverting in the summer of 2002.

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. Indeed, Fleming's recognition of the entire \$4 million violated GAAP. Both parties understood the payment was an advance payment on future diverting purchases by Fleming. Fleming therefore was required to recognize the payment ratably as Fleming made the diverting purchases. *See* Statement of Financial Accounting Concepts No. 5, ¶¶ 83-84; Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements*, Question 5. Fleming included these misleading figures in its Form 10-Q for the first fiscal quarter ended April 20, 2002, and in publicly disseminated press releases. Fleming further incorporated the first quarter Form 10-Q into registration statements on Forms S-3, S-8, and S-4 filed during the summer of 2002.

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<sup>4</sup> Fleming operated on a retail calendar with a fiscal first quarter consisting of four four-week periods, followed by three fiscal quarters consisting of three four-week periods each. Fleming's 2002 first fiscal quarter ended on April 20, 2002.

### **C. Conclusion**

As a result of the foregoing, the Commission finds:

(1) Dexsi caused Fleming's violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-1, 13a-13 and 13b2-1 thereunder;

(2) Rosario Coniglio caused Fleming's violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-1, 13a-13 and 13b2-1 thereunder; and

(3) Steven Schmidt caused Fleming's violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-1, 13a-13 and 13b2-1 thereunder.

### **IV.**

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in the Offer.<sup>5</sup>

Accordingly, IT IS HEREBY ORDERED, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, that Respondents Dexsi, Coniglio and Schmidt cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) and 17(a)(3) of the Securities Act, and causing any violations and any future 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.

By the Commission.

Jonathan G. Katz  
Secretary

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<sup>5</sup> Dexsi has agreed to pay a \$100,000 civil penalty, and Coniglio and Schmidt each have agreed to pay \$75,000 civil penalties, in connection with a parallel civil action.