

**IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION**

SECURITIES AND EXCHANGE COMMISSION,	:	
	:	
Plaintiff,	:	
	:	Civil Action No.: 1:11-cv-0056-TCB
v.	:	
	:	
STANLEY J. KOWALEWSKI and SJK INVESTMENT MANAGEMENT, LLC,	:	
	:	
Defendants.	:	
	:	
	:	

**PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S
PRE-HEARING BRIEF**

Pursuant to the Court's September 21, 2011 Order [Dkt 128], Plaintiff Securities and Exchange Commission (the "Commission") respectfully submits this Brief summarizing: (1) the evidence the Commission expects to present at the September 29, 2011 contempt hearing; (2) the issues to be decided by the Court in connection with the contempt hearing; and (3) the evidence and issues to be decided by the Commission's Motion for Disgorgement and Civil Penalties ("Motion for Disgorgement") [Dkt 113]

I. The Evidence the Commission Will Present Regarding Kowalewski's Contempt

The Commission intends to present evidence that Stanley Kowalewski looted the house located at 5802 Henson Farms Road, Summerfield, North Carolina (the "Henson Farms House"). The Commission also intends to show that, contrary to the Court's August 31 Order, Kowalewski failed to properly account for what he took from the Henson Farms House, failed to bring the Henson Farms House back to its condition before he gutted it, and failed to otherwise comply with the Court-ordered steps necessary to bring the house back to its earlier condition.

More specifically, the Commission expects to present evidence that:

1. Pursuant to Orders dated January 6, 2011, January 26, 2011, and June 29, 2011, the Court, among other things, froze all the assets under Kowalewski's control (the "Freeze Orders"). [Dkt 5, 23, 101]
2. Pursuant to Orders dated February 2, 2011 and March 8, 2011, the Court took exclusive jurisdiction and possession of, and appointed a receiver for, Mr. Kowalewski's assets (the "Receiver Estate"). [Dkt 37, 59]
3. The Henson Farms House, which Kowalewski and his wife purchased for \$2.9 million with money stolen from investors, is subject to the Freeze Orders and is an asset of the Receiver Estate – a fact of which Kowalewski is aware.

4. Without the knowledge or permission of the Court-appointed Receiver, and in violation of the Freeze Orders, Kowalewski removed, or caused the removal of, high-end kitchen appliances, the built-in central house vacuum system, cabinetry and counters, interior and exterior lighting, doors, and bathroom sinks and vanities (the “Fixtures”). Kowalewski also caused significant damage to the Henson Farms House while removing the Fixtures. An example of the looting and destruction is shown below:¹



¹ When this photograph is compared with the “before” photographs of the kitchen, the extent of the damage is obvious. *See* Dkt 116-1, pp. 2-5. The custom refrigerator, the range and hood, the granite countertops, the sinks and much more are gone.

5. The injury Kowalewski caused to the Receiver Estate by removing the Fixtures is significant. The Commission can present evidence that returning the house to marketable condition will cost substantial sums.² Obviously, if not repaired, the damage will materially reduce the market value of the Henson Farms House and decrease the sales proceeds distributed to investors.

6. On August 30, 2011, Kowalewski's counsel conveyed to the Commission a proposal to return the Fixtures and restore the Henson Farms House to its earlier condition. [Dkt 125, p. 11]

7. On August 31, 2011, the Court deferred ruling on whether Kowalewski was in contempt of the Freeze Orders and ordered Kowalewski to engage in a series of steps designed to restore the Henson Farms House to its condition before his looting (the "August 31 Order"). [Dkt 120]

8. Kowalewski failed to meet the requirements of the August 31 Order in almost every way and has engaged in a pattern of deceptive and dishonest conduct with respect to his purported compliance with that order. The evidence the Commission expects to present in this regard includes:

- a. Kowalewski failed to provide a complete and accurate accounting, under oath, of the Fixtures and personal property removed from the

² See, e.g., September 19, 2011 Declaration of Kevin Combs at ¶¶ 9-10. [Dkt 127]

House. (See August 31 Order, ¶¶ 3-4.) Kowalewski has provided inconsistent, incomplete, and misleading information about what happened to the removed assets. For example, the Commission expects to present evidence that WBM Contracting, Inc. – an entity Kowalewski claims removed certain Fixtures – had nothing to do with any work at the Henson Farms House.

- b. Kowalewski failed to return the Fixtures, or replace the Fixtures unsuitable for reinstallation, with new items of similar quality. (See *id.*, ¶¶ 5-6.) The Commission expects to present evidence that the Henson Farms House remains in the miserable state illustrated in paragraph 4 above. Moreover, Kowalewski disingenuously attempted to replace high-end Fixtures (such as a custom Sub-Zero refrigerator and Viking appliances) with products of substantially lower quality, as illustrated by the picture below:³

³ See September 8 and 19, 2011 Declarations of Mark Scott. [Dkt 129-2, 129-3]



- c. Kowalewski failed to make a good faith proposal for the performance of the necessary repair work at the House to restore it to its prior condition. (*See id.*, ¶ 9.) On its face, the \$11,500 proposal submitted by Kowalewski does not include the cost of the removed and/or damaged Fixtures and bears no reasonable relation to the estimate of provided by the original builder of the Henson Farms House.
9. Kowalewski's bad faith has complicated resolution of this matter and diminished the assets of the Receiver Estate, resulting in further depletion of the money that can be returned to investors due to Kowalewski's securities fraud.

II. The Issues for Court Decision

The Commission respectfully submits that, with regard to the contempt motion, there are two issues ripe for decision by the Court: *first*, whether Kowlaweski committed contempt and, *second*, whether the Court can design a coercive remedy that will bring about compliance with its orders. With respect to the first issue for decision, the Commission submits that the evidence overwhelmingly supports the conclusion that Kowalewski is in contempt of the Freeze Orders and the August 31 Order. *See Riccard v. Prudential Ins. Co.*, 307 F.3d 1277, 1296 (11th Cir. 2002) (“In a contempt proceeding, the moving party, here the government, must prove by clear and convincing evidence that: (1) a valid court order was in effect; (2) the order was clear and unambiguous; and (3) the alleged violator could have complied with the court's order, had he chosen to do so.”).

With respect to the second issue, the Commission submits that Kowalewski should provide, under oath and in the Court’s presence, a complete and accurate accounting of the Fixtures and personal property removed from the Henson Farms House, which accounting shall include: when the items were removed and by whom; the present location of each item; the name and contact information for all custodians; any consideration received for such item; and the location, use, transfer

and/or dissipation of such consideration. This information is necessary to minimize harm to investors by either returning the fixtures removed or establishing by independent third-party evidence that they have, in fact, been destroyed.

Although the Court can – and should – order that Kowalewski compensate the Receiver Estate for his contemptuous conduct in an amount reflective of the cost to repair the Henson Farms House and pay for the items that were taken, Kowalewski is unlikely to have the financial resources to do so. As such, information leading to the return of the Fixtures is likely more valuable than Kowalewski’s obligation to pay for them.⁴ Kowalewski’s failure to provide a complete accounting of the Fixtures – as required by the August 31 Order – should subject him to an appropriate coercive sanction. *See, e.g., Combs v. Ryan’s Coal Co.*, 785 F.2d 970, 981 (11th Cir. Ala. 1986) (“When an order of incarceration is conditioned upon a

⁴ “The measure of the court’s power in civil contempt proceedings is determined by the requirements of full remedial relief.” *Citronelle-Mobile Gathering, Inc. v. Watkins*, 943 F.2d 1297, 1304 (11th Cir. 1991) (quotation omitted). Thus, this court has “broad discretion in fashioning civil contempt sanctions,” *Howard Johnson Co. v. Khimani*, 892 F.2d 1512, 1519 (11th Cir. 1990), and may “impose coercive and compensatory sanctions.” *Citronelle*, 943 F.2d at 1304. Both a monetary remedy and imprisonment may be proper remedies. *CFTC v. Wellington Precious Metals, Inc.*, 950 F.2d 1525 (11th Cir. 1991).

refusal to comply in good faith with a court order then the purpose is coercive. Such incarceration represents a legitimate use of the civil contempt”).⁵

III. Disgorgement, Prejudgment Interest, and Civil Penalties

As the Motion for Disgorgement is ripe for consideration and no opposition has been filed in response, the Commission respectfully requests that the Court order the requested disgorgement and prejudgment interest amounts and appropriate civil penalties against Kowalewski.

Pursuant to the Court’s June 29, 2011 Order (to which Kowalewski expressly consented), the allegations of the Complaint are to be “accepted as and deemed true by the Court,” and Kowalewski is “precluded from arguing that he did not violate the federal securities laws” in connection with a Commission motion for disgorgement and/or civil penalties. [Dkt 97-1, 97-2] On August 24, 2011, the Commission filed its Motion for Disgorgement. [Dkt 113] As set forth in that Motion and its accompanying filings (incorporated herein by reference), Kowalewski should be required to disgorge \$8,420,923.45 in ill-gotten gains, plus pre-judgment interest of at least \$193,610.40, for a total disgorgement amount of

⁵ Also available to the Court should the need arise is the ability for the Court to enter an order pursuant to Rule 42(a) of the Federal Rules of Criminal Procedure requiring Kowalewski to show cause why he should not be held in criminal contempt.

\$8,614,533.85.⁶ The Commission also set forth various methods by which the Court could calculate appropriate civil penalties.

At the Court's August 31, 2011 court hearing on the Order to Show Cause, Kowalewski agreed to submit any response he had relating to the Motion for Disgorgement by Monday, September 12, 2011,⁷ following which no further briefing on the Motion would be permitted, and the Motion would be ripe for the Court's ruling.

Neither on September 12, 2011, nor on any later date, has Kowalewski submitted to the Court any opposition to the Motion for Disgorgement. Rather, as set forth in the Commission's Reply Brief filed on September 12, 2011 (also incorporated herein by reference), Kowalewski's only "response" was a cryptic and conclusory two-page letter sent to the Commission on Sunday, September 11,

⁶ The prejudgment interest amount set forth in the Commission's initial moving papers was calculated as of the date of filing, August 24, 2011. Bringing the interest calculation forward to September 30, 2011 (and even excluding prejudgment interest for the month of January, 2011), the total prejudgment interest is \$211,385.34, which combined with the disgorgement amount totals \$8,632,308.79. *See* "Exhibit A."

⁷ Under Local Rule 7.1(B), Kowalewski's response to the Motion for Disgorgement would have been due within fourteen (14) days, or by September 7, 2011.

2011.⁸ [Dkt 121] Such letter not only failed to provide any response regarding the appropriate penalties, but also failed to explain what Kowalewski's sought-after reductions constitute, to tie such reductions to any amounts identified by the Commission, or to provide any reason(s) or justification(s) for such reductions or a salary compensation "credit" of \$6 million. In so doing, Kowalewski failed to satisfy his burden of establishing that the proposed disgorgement or penalty amounts are inappropriate. *See e.g., SEC v. Hughes Capital Corp.*, 917 F. Supp. 1080, 1085 (D.N.J. 1996). Accordingly, the Commission respectfully submits that the Motion for Disgorgement is ripe for the Court's decision and respectfully requests that the Court impose the requested disgorgement and prejudgment interest amounts and appropriate civil penalties.⁹

⁸ A copy of that letter was attached as Exhibit B to the SEC's September 12 Reply brief. [Dkt 121-2]

⁹ While likely unnecessary, the Commission will have available at the hearing to testify James Begnaud, CPA, who provided the sworn declaration previously submitted to the Court in connection with the Motion for Disgorgement. [Dkt 113-2]

III. Conclusion

For the reasons summarized herein, the Commission respectfully submits that the evidence warrants holding Kowalewski in contempt and warrants imposing the requested disgorgement and prejudgment interest amounts and appropriate civil penalties.

Dated: September 27, 2011

Respectfully submitted,

By: /s/ Alex Rue
Senior Trial Counsel
Georgia Bar No. 618950
Email: ruea@sec.gov

Paul T. Kim
Senior Trial Counsel
Georgia Bar No. 418841
Email: kimpau@sec.gov

COUNSEL FOR PLAINTIFF
Securities and Exchange Commission
3475 Lenox Road, N.E., Suite 500
Atlanta, GA 30326-1232
Tel. No.: (404) 842-7600
Fax No.: (404) 842-7633

EXHIBIT A



U.S. Securities and Exchange Commission

Division of Enforcement

Prejudgment Interest Report

Quarter Range	Annual Rate	Period Rate	Quarter Interest	Principal+Interest
Violation Amount				\$8,420,923.45
02/01/2011-03/31/2011	3%	0.48%	\$40,835.71	\$8,461,759.16
04/01/2011-06/30/2011	4%	1%	\$84,385.76	\$8,546,144.92
07/01/2011-09/30/2011	4%	1.01%	\$86,163.87	\$8,632,308.79
Prejudgment Violation Range			Quarter Interest Total	Prejudgment Total
02/01/2011-09/30/2011			\$211,385.34	\$8,632,308.79