INITIAL DECISION RELEASE NO. 307
ADMINISTRATIVE PROCEEDING
FILE NO. 3-11909

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:	
	:	INITIAL DECISION
	:	February 17, 2006
PHLO CORPORATION, JAMES B. HOVIS, and ANNE P. HOVIS	:	

APPEARANCES: Robert K. Levenson and Scott A. Masel for the Division of Enforcement, Securities and Exchange Commission.

James B. Hovis, pro se.

Anne P. Hovis, pro se, and as executive vice president of Phlo Corporation.

BEFORE: James T. Kelly, Administrative Law Judge.

The Securities and Exchange Commission (SEC or Commission) instituted this proceeding on April 21, 2005, pursuant to Sections 12(j), 17A, and 21C of the Securities Exchange Act of 1934 (Exchange Act).

The Order Instituting Proceedings (OIP) alleges that Phlo Corporation (Phlo), an issuer of publicly traded securities, failed to make timely filings of annual and quarterly reports with the Commission after March 2003. The OIP further asserts that Phlo, a transfer agent for its own securities, refused to cancel share certificates and issue new ones within three business days, despite an obligation to do so as a transfer agent. Finally, the OIP charges that Phlo failed to provide documents or otherwise respond in a timely manner to an examination by the Commission's Office of Compliance Inspections and Examinations (OCIE).

The OIP alleges that, through this conduct, Phlo violated Section 13(a) of the Exchange Act and Exchange Act Rules 13a-1 and 13a-13. It also asserts that Phlo willfully violated Sections 17A(d)(1) and 17(b)(1) of the Exchange Act and Exchange Act Rules 17Ad-2 and 17Ad-5. The OIP further charges that James B. Hovis (James Hovis) and Anne P. Hovis (Anne Hovis), Phlo's officers, willfully aided and abetted and caused Phlo's violations.

As sanctions for the alleged misconduct, the Commission's Division of Enforcement (Division) seeks to revoke the registration of Phlo's common stock, to revoke Phlo's registration as a transfer agent, and to bar Anne Hovis from associating with any transfer agent. The Division also requests cease-and-desist orders and civil monetary penalties against all three Respondents.

I held three days of public hearings in Washington, D.C., during September and October 2005.[1] The parties then filed proposed findings of fact, proposed conclusions of law, briefs, and reply briefs.[2]

I base my findings and conclusions on the entire record and on the demeanor of the witnesses who testified at the hearing. I applied "preponderance of the evidence" as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 97-104 (1981). I have considered and rejected all arguments, proposed findings, and proposed conclusions that are inconsistent with this decision.

FINDINGS OF FACT

Respondents

Phlo was incorporated in Delaware in 1995 as Perry's Majestic Beer, Inc. (Perry's Majestic Beer). The company adopted its current name in April 1999 (DX 33 at 15). Phlo and its affiliates manufacture and distribute beverages and liquids containing patented and patent-pending biotechnologies (Tr. 233-35; DX 33 at 4). Phlo sells its products to distributors who offer them for resale to the public in supermarkets, drugstores, and convenience stores (DX 33 at 4).

Phlo's common stock is registered with the Commission under Section 12(g) of the Exchange Act (DX 33 at 1). Until 2004, prices for Phlo's common stock were posted on the

[1] The hearing transcript will be cited as "Tr. ___." The Division's exhibits and Respondents' exhibits will be cited as "DX ___" and "RX ___," respectively. The deposition of Eric Swanson will be cited as "ES Dep. at ___."

[2] The Division's Amended Proposed Findings of Fact and Conclusions of Law and the Division's Post-Hearing Reply Brief will be cited as "Div. Prop. Find. ___" and "Div. Reply Br. ___," respectively. Respondents' Post-Hearing Brief and Respondents' Post-Hearing Reply Brief will be cited as "Resp. Br. ___" and "Resp. Reply Br. ___," respectively. The Division also filed a Prehearing Brief, which will be cited as "Div. Prehear. Br. ___."

The parties have urged me to take official notice of Phlo's filings on EDGAR, pursuant to Rule 323 of the Commission's Rules of Practice (Tr. 259-60, 367; Div. Prop. Find. at 4 n.2; Resp. Br. at 1 n.2). I have done so throughout this Initial Decision.

NASD's Over-the-Counter Bulletin Board (OTCBB) (Tr. 282; RX 10).[3] Thereafter, prices for Phlo's common stock have been quoted by The Pink Sheets LLC (Pink Sheets).[4] Phlo had 208,828,909 shares of common stock outstanding as of December 31, 2004 (DX 33 at 1).

Phlo's registration as a transfer agent became effective in July 2002 (Answer; DX 15 at Form TA-1).[5] See Exchange Act Rule 17Ac2-1. Phlo has acted as a transfer agent only for its own securities (Answer). It has never held custodial funds in connection with its transfer function (Answer).

James Hovis, age fifty-six, is a law school graduate (Answer; DX 33 at 52). He has been Phlo's president, chief executive officer, and a director from December 1998 to the present (DX 15 at Form TA-1). James Hovis is responsible for the overall management of Phlo's activities as an issuer, and he signs Phlo's annual and quarterly reports to the Commission (Answer; Tr. 15, 19-20; DX 33 at 66).

Anne Hovis, age forty-five, is also a law school graduate (Answer; DX 33 at 52). She is Phlo's executive vice president, general counsel, secretary, and a director, and oversees Phlo's activities as a transfer agent (Answer; Tr. 15, 20-21; DX 33 at 66).

James and Anne Hovis are husband and wife (DX 33 at 60). They reside in Washington, D.C., in an apartment rented by a Phlo affiliate (Prehearing Conference of June 1, 2005, at 7; Tr.

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[3] The OTCBB is an electronic inter-dealer quotation system that displays real-time quotes, last-sale prices, and volume information for many over-the-counter securities that are not quoted on the Nasdaq Stock Market or listed on a national securities exchange. Under the OTCBB's eligibility rules, companies that want to have their securities quoted on the OTCBB must file current financial reports with the Commission or with their banking or insurance regulators.

[4] The Pink Sheets is an electronic inter-dealer quotation system that displays quotes and last-sale information for many over-the-counter securities. The name comes from the color of paper used when the sheets circulated in hard copy. Unlike the OTCBB, the Pink Sheets does not require companies whose securities are quoted on its system to meet any listing requirements. Many of the companies listed on the Pink Sheets do not file periodic reports or audited financial statements with the Commission.

[5] Transfer agents record changes of ownership, maintain an issuer's security holder records, cancel and issue certificates, and distribute dividends. Efficient transfer agent operations are critical to the successful completion of secondary market trades. Section 17A(c) of the Exchange Act requires that transfer agents be registered with the Commission or, if the transfer agent is a bank, with a bank regulatory agency. There is no self-regulatory organization that governs transfer agents. The Commission has therefore promulgated rules and regulations for all registered transfer agents, intended to facilitate the prompt and accurate clearance and settlement of securities transactions. The rules include minimum performance standards regarding the issuance of new certificates and related recordkeeping and reporting requirements. The Commission also conducts examinations of transfer agents.

27, 324, 329). The Hovises claim domicile in Richmond, Virginia (Prehearing Conference of June 1, 2005, at 7; Tr. 328-29). James and Anne Hovis owned or controlled more than 22 million shares of Phlo common stock as of December 31, 2004 (DX 33 at 58-59) (more than 26% of the common stock).

Non-Parties

Allen G. Hoube, Jr. (Hoube), also known as "Skip" Hoube, was Phlo's vice president of production operations from December 1998 to April 2004 (Tr. 207, 213; DX 15 at Form TA-1, DX 33 at 52-53). He has continued to perform production work for Phlo on a consulting basis to the present (Prehearing Conference of June 1, 2005, at 9; Tr. 339). In 2002, Hoube maintained an address in Budd Lake, New Jersey (DX 4). He now lives in Orange Park, Florida (Tr. 214). Hoube is not a party to the proceeding, and the OIP does not charge him with any misconduct.

Depository Trust Company (DTC) is a limited trust company, registered with the Commission as a clearing agency and a self-regulatory organization, and it is regulated by the Federal Reserve System (Tr. 33). Its primary role is to act as a depository, holding securities on behalf of its participants (Tr. 33).[6] In this role, DTC interacts daily with transfer agents by sending them packages of securities or communicating with them regarding securities (Tr. 33). DTC is not a party to the proceeding, and the OIP does not charge it with any misconduct.

Phlo's Transfer Agent Premises

The OIP alleges that Phlo has its principal offices in Jacksonville, Florida. The reality is somewhat more complicated. Phlo, the issuer of registered securities, maintained its office in New York City until early in 2002 (Form 10-QSB filed 2/19/02 (official notice)). It then leased office space from an employee on an informal, rent-free basis in Budd Lake, New Jersey (Form 10-KSB filed 7/15/02 (official notice)). Phlo's most recent annual report states that its "principal executive office" is in Jacksonville, Florida (Form 10-KSB filed 11/15/05 (official notice)).

In May 2002, when Phlo applied to register as a transfer agent, it informed the Commission that it would be conducting its transfer agent activities from 1825 K Street, N.W., Washington, D.C. 20006, Suite 1450 (DX 15 at Form TA-1). Phlo occupied this office from May 2002 to May 2004 (Tr. 325; RX 10, e-mail from Anne Hovis dated 4/22/04). It initially sublet space from a friend of James Hovis (Tr. 332). Subsequently, Advanced Biodelivery, LLC (Advanced Biodelivery), a Phlo affiliate, sublet the space from a pharmaceutical company that is not related to Phlo (Tr. 324-25, 332). The pharmaceutical company leased a suite of approximately twenty offices from the landlord at 1825 K Street. Advanced Biodelivery sublet three offices and a conference room from the pharmaceutical company on a month-to-month basis (Tr. 211, 214).

[6] DTC holds securities certificates in bulk form for its participants and maintains ownership records of the securities on its own books.

From May 2004 through the time of the hearing, Phlo conducted transfer agent activities at 1133 Connecticut Avenue, N.W., Washington, D.C. 20006, Suite 200 (Tr. 323-24). Advanced Biodelivery leases the space and provides part of it to Phlo (Tr. 324). Phlo has never filed a Form TA-2 to notify the Commission that it is performing its transfer agent functions from the 1133 Connecticut Avenue address (Tr. 324).

In August 2002, Phlo informed the Commission that it would be conducting its transfer agent activities from Budd Lake (DX 15 at Form TA-1 (amended)). However, Anne Hovis described the Budd Lake address as one that Phlo used during a "transitional stage," when it was unclear where the officers would relocate after they had decided to leave New York City (Tr. 28-29).

DTC was unable to communicate with Phlo at the Budd Lake address during May and early June 2003 (Tr. 50-51; DX 15). DTC sent several packages to the Budd Lake address by overnight courier, but the packages were returned as undeliverable (Tr. 51). At about this time, Phlo informed DTC that it should forward requests for transfers of stock certificates to Jacksonville.[7] However, Phlo did not notify the Commission that the Budd Lake address was no longer valid (Tr. 28-30; Resp. Br. at 21 n.11).

In a series of untimely periodic reports filed with the Commission during 2005, Phlo identified its "principal executive office" as 6001-21 Argyle Forest Blvd., PMB # 117, Jacksonville, Florida 32244 (DX 33-DX 36, DX 59; RX 11). The Argyle Forest Blvd. address is occupied by a MailBoxes Etc. store (Tr. 26, 327). "PMB # 117" is a private mail box (Tr. 26-27).

When Phlo receives correspondence or items for transfer in Jacksonville, MailBoxes Etc. notifies Houbé (Tr. 27-28, 328). Houbé, who lives in nearby Orange Park, then retrieves the items and transmits them by facsimile or overnight courier to James and Anne Hovis in Washington, D.C. (Tr. 214, 328).

I find as a fact that Phlo used its Budd Lake and Jacksonville addresses as "drops," and that Phlo never actually performed transfer agent functions at either location. I also find as a fact that Phlo has performed its transfer agent functions from premises in Washington, D.C., at all times relevant to this proceeding. Finally, I find as a fact that Phlo had appropriate procedures in place for promptly forwarding items for transfer from Jacksonville to Washington, D.C., during and after June 2003.

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[7] Phlo notified DTC of its address change in correspondence dated May 8 and June 5, 2003 (DX 15, DX 17). However, Phlo used Budd Lake as the dateline on a press release it issued on May 29, 2003 (RX 17). Even as late as August 15, 2003, Phlo continued to use the Budd Lake address on its letterhead stationery (Tr. 64; DX 12).

Phlo used its Jacksonville address in a notice of late filing (Form 12b-25) that it filed with the Commission on August 15, 2003 (DX 32). Thereafter, Phlo did not file any periodic reports with the Commission until January 2005 (DX 33).

A. Phlo's Violations of Exchange Act Rules Concerning Issuers of Securities.

Section 13(a) of the Exchange Act and Exchange Act Rules 13a-1 and 13a-13 require issuers of securities registered under Section 12 of the Exchange Act to file annual and quarterly reports with the Commission. An issuer's annual report is due within ninety days after the end of its fiscal year. See 17 C.F.R. §§ 249.310, .310b. An issuer's quarterly reports are due within forty-five days after the end of each of the first three quarters of its fiscal year. See 17 C.F.R. §§ 249.308a, .308b. Phlo's fiscal year ends on March 31 (Tr. 257).

Phlo's Overdue Periodic Reports

From March 2003 to November 2005, Phlo failed to file three annual and eight quarterly reports on time (Answer; Tr. 15-16, 352). The following chart summarizes Phlo's history of untimely filings:

Period ended	Form	Due Date	Date Filed	How Late	Source
3/31/03	10-KSB	6/30/03	1/04/05	18 months +	DX 33
6/30/03	10-QSB	8/14/03	4/18/05	20 months +	DX 34
9/30/03	10-QSB	11/14/03	4/25/05	17 months +	DX 35
12/31/03	10-QSB	2/16/04	5/02/05	15 months +	DX 36
3/31/04	10-KSB	6/29/04	7/08/05	12 months +	DX 59
6/30/04	10-QSB	8/16/04	9/23/05	13 months +	RX 11
9/30/04	10-QSB	11/15/04	10/05/05	10 months +	official notice
12/31/04	10-QSB	2/14/05	10/12/05	8 months	official notice
3/31/05	10-KSB	6/29/05	11/15/05	4 months +	official notice
6/30/05	10-QSB	8/15/05	11/28/05	3 months +	official notice
9/30/05	10-QSB	11/14/05	11/29/05	2 weeks	official notice

During the first eleven months of 2005, Phlo filed three overdue Forms 10-KSB and eight overdue Forms 10-QSB. On February 9, 2006, Phlo timely filed a Form 10-QSB for the quarter ended December 31, 2005 (official notice). With the filing of this most recent quarterly report, Phlo is now current in its financial reporting.

At first glance, Phlo's recent periodic reports suggest severe financial problems. For example, Phlo reported revenues of $45,858 in fiscal year 2003; $784,896 in fiscal year 2004; and $0 in fiscal year 2005 (DX 33 at 17, DX 59 at 10; Form 10-KSB filed 11/15/05 at 1, 8). Revenues during fiscal year 2004 resulted from the receipt of product distribution right fees, not product sales (DX 59 at 10). Phlo reported net losses of $2,442,974 in fiscal year 2003; $2,893,137 in fiscal year 2004; and $2,815,000 in fiscal year 2005 (DX 33 at 17, 27, DX 59 at 10, 19; Form 10-KSB filed 11/15/05 at 10, F-5). Phlo's annual report for fiscal year 2005 reveals that the company is delinquent in paying its trade payables, notes payable, and accrued payroll taxes and related interest and penalties (Form 10-KSB filed 11/15/05 at F-15). Phlo's outside auditors affixed "going concern" qualifications to their reports on the company's

financial condition for fiscal years 2003, 2004, and 2005 (DX 33 at 24, DX 59 at 16; Form 10-KSB filed 11/15/05 at F-16).[8]

However, the lack of product sales, the net losses, the delinquent payables, and the going concern qualifications have not prevented Phlo from rewarding James Hovis for his stewardship. Phlo paid James Hovis a salary of $117,400 in fiscal year 2002; $287,692 in fiscal year 2003; $409,039 in fiscal year 2004; and $421,508 in fiscal year 2005 (DX 33 at 54, DX 59 at 46; Forms 10-KSB filed 11/15/05 at Part III, Item 10 and filed 7/15/02 at Part III, Item 9 (official notice)). Anne Hovis's salary decreased from $99,000 in fiscal year 2002 to $42,885 in fiscal year 2003 (DX 33 at 54, DX 59 at 46). Phlo has not paid her any salary for the last two years.

Phlo's Explanation: Unqualified Independent
Auditors and Unresponsive Contract Bookkeepers

Respondents do not dispute that Phlo failed to make timely filings of periodic reports from March 2003 to November 2005. They contend that the delinquencies were due to circumstances beyond their control.

In January 1999, shortly after James and Anne Hovis assumed management of Perry's Majestic Beer, the company discharged its existing auditor and engaged Marcum & Kliegman LLP (Marcum & Kliegman) (Form 8-K filed 2/1/1999 (official notice)). Phlo terminated Marcum & Kliegman on July 2, 2003, in the wake of a billing dispute (Tr. 219-20, 269, 278-80; Forms 8-K filed 7/10/2003 and 8-K/A filed 7/30/2003 (official notice)).

In July 2003, Phlo retained Reznick, Fedder & Silverman (RF&S) as its outside auditor (Tr. 220-21; Form 8-K filed 7/22/03 (official notice)). In April 2004, Phlo discharged RF&S (Form 8-K filed 4/16/04 (official notice)). James and Anne Hovis wanted RF&S to provide a valuation of Phlo's intellectual property and technology assets (Tr. 221-22, 281-82). RF&S insisted that Phlo obtain an independent appraisal of these assets (Tr. 221-22). During its nine-month engagement, RF&S never issued a report on Phlo's financial statements.

In April 2004, Phlo engaged Sherb & Co., LLP (Sherb), as its outside auditor (Tr. 16, 283; Form 8-K filed 4/16/04). Sherb ceased its services as Phlo's outside auditor in March 2005 (Forms 8-K filed 4/7/05 and 8-K/A filed 4/12/05 (official notice)). Phlo subsequently complained about Sherb to the Public Company Accounting Oversight Board (Tr. 233; RX 10). The record does not show the current status of Phlo's complaint. During its eleven-month engagement, Sherb issued a report on one of Phlo's financial statements (DX 33 at 23-24). The

[8] Continuation of an entity as a "going concern" is assumed in financial reporting in the absence of significant information to the contrary. Information that significantly contradicts the "going concern" assumption relates to the entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of business, restructuring of debt, externally forced revisions of its operations, or similar actions. See American Institute of Certified Public Accountants, Codification of Statements on Auditing Standards AU § 341.01 (2005).

Division has stipulated that Sherb always lacked a sense of urgency, that there were months of inactivity, and that Sherb continually missed deadlines (Tr. 16, 225-29, 283-87).

In April 2005, Phlo engaged Russell Bedford Stefanou Mirchandi LLP (Russell Bedford) as its outside auditor (Prehearing Conference of 6/7/05 at 7; Tr. 230-31, 286-87, 349-50). Peter Stefanou, CPA (Stefanou), is the Russell Bedford partner managing the Phlo engagement.

Phlo does not employ a full-time, in-house bookkeeper. Instead, it has contracted with a series of outside consultants who provide bookkeeping services on an as-needed basis. During the past three years, Phlo engaged Abob and Company, then David Langle, CPA (Langle), and then Robert Scherne, CPA (Scherne), as its contract bookkeepers (Prehearing Conference of June 7, 2005, at 14; Tr. 224, 352-53). At an early stage of this proceeding, Stefanou characterized Langle as having expertise in SEC reporting requirements. He also stated that Langle was responsive to his inquiries (Prehearing Conference of June 7, 2005, at 11, 14, 26). Anne Hovis and Stefanou later criticized Langle as unresponsive (Prehearing Conference of August 2, 2005, at 24; Tr. 350-51). At Stefanou's suggestion, Phlo replaced Langle with Scherne (Tr. 352-53).

B. Phlo's Violations of Exchange Act Rules Concerning Registered Transfer Agents.

1. Phlo's Violations of the Turnaround Rules.

The Applicable Standards

The Commission has established minimum performance standards for registered transfer agents in connection with the timely cancellation and issuance of securities certificates. See Regulation of Transfer Agents, 12 SEC Docket 853 (June 16, 1977) (turnaround rules). Under these rules, registered transfer agents must turn around within three business days of receipt at least 90% of all routine items received for transfer during a month. Exchange Act Rule 17Ad-2(a). Routine items not turned around within three business days of receipt must be turned around "promptly." Exchange Act Rule 17Ad-2(e)(1). Under usual circumstances, that means within one additional business day. See Regulation of Transfer Agents, 12 SEC Docket at 859. All non-routine items must receive diligent and continuous attention and must be turned around as soon as possible. Exchange Act Rule 17Ad-2(e)(1).

A deposit shipment control list (SCL) is a list of transfer instructions that accompanies certificates to be cancelled and reissued in the nominee name of a registered clearing agency. Exchange Act Rule 17Ad-1(a)(3). Each line on a deposit SCL submitted by a registered clearing agency is a separate item for purposes of the turnaround rules. Exchange Act Rule 17Ad-1(a)(1)(ii).

The receipt of an item occurs when the item arrives at the premises at which the transfer agent performs transfer agent functions. Exchange Act Rule 17Ad-1(g). A registered transfer agent that receives items at locations other than the premises at which it performs transfer agent functions must have appropriate procedures to assure that items are forwarded to such premises promptly. Exchange Act Rule 17Ad-2(f). If a registered transfer agent maintains a "drop" address located a significant distance from the transfer premises, the items are not deemed to

have been received for purposes of the turnaround rules until they arrive at the actual premises where transfer agent functions are performed. See Regulation of Transfer Agents, 12 SEC Docket at 856; see also Regulation of Transfer Agents, Interpretation of Rules, 20 SEC Docket 1277, 1285 (Sept. 2, 1980) (Staff Interpretation) (Question 28).[9]

The three-business-day turnaround requirement in Exchange Act Rule 17Ad-2(a) applies only to routine items. However, the definition of a "routine" item is stated in the negative. Exchange Act Rule 17Ad-1(i). Thus, an item received for transfer is deemed routine unless it falls within the specified exceptions enumerated in Exchange Act Rule 17Ad-1(i)(1)-(8). A transfer agent must decide whether an item is routine or non-routine as soon as it reviews the item upon receipt at the transfer premises. Once a transfer agent determines that an item is routine, the item generally retains that classification throughout the completion of turnaround. Thus, an otherwise routine item does not become non-routine because of internal delays in the turnaround of the item. See Staff Interpretation, 20 SEC Docket at 1286 (Question 31).

Phlo Becomes the Transfer Agent for Its Own Securities and Clashes Repeatedly with DTC

American Stock Transfer & Trust Company (ASTTC) was Phlo's transfer agent until July 2002 (Tr. 69-70, 236; DX 4). At about that time, Phlo decided to become the transfer agent for its own securities (Tr. 237; DX 15 at Form TA-1). Brokers and dealers entered transactions in Phlo's shares in DTC's electronic system before and after the change in transfer agents (Tr. 33, 97, 238).

Phlo and DTC had an adversarial relationship from the outset. For example, Phlo claimed that DTC ignored it for six months after it registered as a transfer agent (Tr. 238, 288-90; DX 4, DX 17). It is undisputed that DTC treated Phlo's shares as non-transferrable between July and December 2002 (Tr. 69-70). However, the record does not permit a finding as to whether the responsibility for this lack of communication was Phlo's or DTC's. ASTTC notified DTC in July 2002 that it had ceased to act as Phlo's transfer agent (Tr. 69-70, 289; DX 4). DTC claimed that it was not timely informed about the identity of the successor transfer agent (Tr. 70). There is no evidence that Phlo provided DTC with written notice that it was acting as the successor transfer agent until December 2002 (Tr. 70; DX 4). See Exchange Act Rule 17Ad-16(a)-(b).

[9] The Commission has noted that "interpretive responses by the staff are subject to reconsideration and should not be regarded as precedents binding on the Commission." Public Availability of Requests for No-Action and Interpretive Letters and Responses Thereto by the Commission's Staff, Securities Act Release No. 5098 (Oct. 29, 1970), 35 Fed. Reg. 17779 (Nov. 19, 1970).

Once DTC learned that Phlo was the successor transfer agent, it wanted Phlo to sign its standard operating agreement. Phlo refused to do so (Tr. 49, 72-74, 96, 238-39, 289).[10] The dispute was never resolved.

By letters dated February 4 and May 8, 2003, Phlo informed DTC that it had encountered delays in registering items that DTC had presented to it for transfer (DX 15). Phlo asserted that the delays were due to the lack of written instructions from DTC (DX 15).[11] There is no evidence that DTC responded in writing to Phlo's letters of February 4 or May 8, 2003.

The principal reason for Phlo's hostility towards DTC was the Hovises' belief that DTC's electronic clearing system facilitated naked short selling, which, in turn, artificially depressed the market price of Phlo's common stock (Tr. 51, 110-12, 124; RX 12, RX 13).[12]

On December 12, 2002, Anne Hovis told DTC that it was "not authorized to act as a trustee, paying agent, transfer agent, or agent in any other capacity whatsoever for Phlo Corporation or its securities" (DX 4). In subsequent discussions, Anne Hovis notified DTC that Phlo was discontinuing the use of DTC's services and moving to a certificate-only clearing mode (Tr. 51, 293; DX 17; RX 17). On June 5, 2003, Anne Hovis told DTC that it was not authorized "to act in any capacity whatsoever for Phlo or its securities" (DX 17). She also wrote (DX 17):

> From this date forward, Phlo will honor certificates representing its common stock registered in the name of [DTC's nominee] only for the purpose of transferring shares represented by such certificates into the names of the actual beneficial holders of the securities.

DTC took the position that an issuer like Phlo had no legal or beneficial interest in its securities and could not request that they be withdrawn from DTC's system. DTC believed that only the participants in its system (brokers, dealers, and banks) could withdraw securities from DTC's depository. In February 2003, DTC filed with the Commission a proposed rule change to

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[10] It is impossible to determine the merits of Phlo's position on these issues. ASTTC's written notice to DTC is not part of the record. DTC's standard operating agreement is not part of the record, either.

[11] If an item requires additional instructions before transfer may be effected, the item would be non-routine. See Exchange Act Rule 17Ad-1(i)(3). Non-routine items are not subject to the three-business-day turnaround rule. However, a transfer agent is responsible for making the "routine" vs. "non-routine" determination immediately upon receipt of each item at its transfer premises. See supra p. 9. The record makes it impossible to determine whether Phlo made a timely determination that the items referenced in its February 4 and May 8, 2003, letters were non-routine.

[12] A short sale is the sale of a stock the seller does not own and must borrow for delivery. In a "naked" short sale, the seller does not borrow or arrange to borrow the securities in time to make delivery to the buyer within the standard three-day settlement period. As a result, the seller fails to deliver securities to the buyer when delivery is due.

effectuate its position.[13] The Commission published DTC's proposed rule change in the Federal Register and solicited public comment. See 68 Fed. Reg. 8535 (Feb. 21, 2003).

June 2003: Phlo Learns that the Commission
Had Approved DTC's Rule Change

The Commission approved DTC's proposed rule change on June 4, 2003 (Tr. 51-53, 114; DX 8). See Depository Trust Company, Order Granting Approval of a Proposed Rule Change Concerning Requests for Withdrawal of Certificates by Issuers, 80 SEC Docket 1309 (June 4, 2003) (DTC Rule Approval Order). As here relevant, the Commission addressed issuers' legal rights and short selling as reasons for attempts to remove securities they had issued from DTC. The Commission determined that the issues surrounding naked short selling are not germane to the manner in which DTC operates as a depository registered as a clearing agency. DTC Rule Approval Order, 80 SEC Docket at 1314. The Commission published its approval in the Federal Register on June 11, 2003.[14] See 68 Fed. Reg. 35037 (June 11, 2003).

Susan Geigel (Geigel) is the Director of Legal and Regulatory Compliance for DTC (Tr. 32). She is familiar with how DTC interacts with transfer agents (Tr. 32). Between December 2002 and June 2003, Geigel had explained DTC's position to Anne Hovis on the telephone and in writing. Geigel provided a copy of the DTC Rule Approval Order to Anne Hovis on June 17, 2003 (DX 8). The DTC Rule Approval Order also received considerable attention in the community of small issuers (RX 14). I find as a fact that Anne Hovis had actual notice that the Commission had approved DTC's rule change no later than June 17, 2003.

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[13] Registered clearing agencies are self-regulatory organizations under Section 3(a)(26) of the Exchange Act. Therefore, changes to a clearing agency's rules after registration may only be made pursuant to Section 19(b) of the Exchange Act (Tr. 117).

[14] The approval was issued "by the Division of Market Regulation, pursuant to delegated authority" and cited 17 C.F.R. § 200.30-3(a)(12). That regulation delegates to the Director of the Division of Market Regulation the authority to approve rule changes proposed by self-regulatory organizations. Approval may be granted by the Director "or under [her] direction by such person or persons as may be delegated from time to time by the Chairman of the Commission." The approval in this instance was granted by Jerry Carpenter (Carpenter), an Assistant Director of the Division of Market Regulation, pursuant to a sub-delegation of authority issued by the Chairman of the Commission (Division's Notice of Filing Copies of Signed Rule Change Approval and Chairman's Delegation of Authority, dated Aug. 4, 2005; Tr. 118-19).

An action made pursuant to delegated authority has immediate effect and is deemed to be the action of the Commission. See Rule 431(e) of the Commission's Rules of Practice. Persons aggrieved by delegated authority action may seek Commission review pursuant to Rule 430(b) of the Commission's Rules of Practice. In this instance, no one sought Commission review of the delegated authority approval of DTC's proposed rule change (Tr. 121-22).

Phlo Fails to Complete the Turnaround of Millions of Shares

By June 2003, Phlo had eliminated any lingering uncertainty as to where DTC should communicate with it. Phlo also knew that the Commission had issued the DTC Rule Approval Order.

DTC sent Phlo deposit SCLs on several dates in June, July, and August 2003: June 5, June 19, June 26, July 2, July 10, July 16, July 17, July 24 (two different SCLs), July 28, July 31, August 5, August 6, August 14, August 19, and August 21 (Tr. 34-37; DX 40). These SCLs represented more than 20.4 million shares (Tr. 34-37; DX 40). The record contains no evidence that Phlo determined that these items were non-routine as it received them for transfer.

All sixteen of these transfers have remained outstanding from the summer of 2003 through the date of the hearing. Anne Hovis estimated that the actual number of outstanding transfers only involved "maybe half of what's listed" by DTC on DX 40 (Tr. 320-22). However, she presented no data to support her lower estimate (Tr. 269-70, 320-22).

Phlo Refuses DTC's Requests To Complete the Transfers

During July and August 2003, DTC's telephone logs show that DTC employees tried to contact Anne Hovis on July 1, 2, 8, 10, 14, 16, and 30 and on August 12 about the deposit SCLs for which Phlo had not completed transfers (Tr. 54-60; DX 41, DX 43-DX 45, DX 47, DX 49-DX 50, DX 52-DX 53). Anne Hovis did not return most of the messages that DTC left for her. Anne Hovis responded once, alleging that her delays were due to a Form 10-K filing, and another time, promising that she would complete some transfers soon (DX 50, DX 55).[15]

DTC prepares Transfer Timeliness Reports for distribution to transfer agents (Tr. 39-40). It characterizes these as "report cards" that enable transfer agents to compare their performance relative to the performance of other transfer agents (Tr. 40). From July 12 to November 1, 2003, DTC sent Phlo nine Transfer Timeliness Reports (Tr. 39-41; DX 58). These reports covered a series of two-week periods from May 30 through October 2, 2003, and identified the issue, the number of shares presented for transfer, the date DTC presented them, and the registered name for the Phlo stock (DX 58). The reports showed that, according to DTC's records, Phlo consistently failed to complete transfers in a timely manner (Tr. 41-47; DX 58). The first page of each Transfer Timeliness Report stated: "In the period ___, you have returned only ___% of the [withdrawals by transfer] that were sent to you." It ended with the statement: "There are still ___ items outstanding and unresolved." As of September 20, 2003, Phlo had fifty-four items outstanding and unresolved (DX 58 at DTC 657). As of October 2, 2003, Phlo had thirty-two items outstanding and unresolved (DX 58 at DTC 663).

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[15] As previously shown, Phlo did not file any Forms 10-K or 10-KSB with the Commission during the summer of 2003. See supra p. 6.

In August 2003, Geigel learned that Phlo still had many transfers outstanding (Tr. 53). Geigel telephoned Anne Hovis, who insisted that Phlo did not have to transfer securities into the name of DTC's nominee and would not do so (Tr. 53).

By letters dated August 21, October 14, and October 16, 2003, Anne Hovis reiterated to DTC that Phlo would honor certificates registered in the name of DTC's nominee only for the purpose of transferring the shares represented by such certificates into the names of the beneficial holders of the securities (DX 12). Anne Hovis also requested DTC to provide additional instructions so that Phlo could issue shares in the names of the beneficial holders (DX 12).

In September and October 2003, Geigel spoke again with Anne Hovis, who still refused to complete the outstanding transfers and return the securities to DTC (Tr. 61-62). Geigel wrote to Anne Hovis on November 5, 2003, demanding that Phlo immediately return the outstanding and overdue shares to DTC (DX 11).

DTC Complains to the Commission's
Division of Market Regulation

The Division of Market Regulation is the Commission staff office that establishes and maintains standards for fair, orderly, and efficient markets. It oversees the major securities market participants, including brokers, dealers, self-regulatory organizations, clearing agencies, and transfer agents. See http://www.sec.gov/divisions/marketreg/mrabout.shtml (official notice).

The Office of Clearance and Settlement is a unit within the Division of Market Regulation. Carpenter, the official who issued the DTC Rule Approval Order, supervises the Office of Clearance and Settlement (Tr. 109). Susan Petersen (Petersen) is an attorney in the Office of Clearance and Settlement (Tr. 106).

In mid-2003, DTC was involved in a series of transfer processing disputes concerning the securities of small issuers (Tr. 107). The Office of Clearance and Settlement attempted to mediate such disputes (Tr. 64-65, 106-07). In the autumn of 2003, Geigel contacted Petersen to complain about Phlo's refusal to complete the transfers that DTC had requested (Tr. 64, 107-08).

Petersen collected information from DTC and then telephoned Phlo to find out its explanation of the relevant events (Tr. 108). Phlo did not return Petersen's initial calls, but eventually asked for a telephonic conference in which Phlo and its outside attorney could participate (Tr. 108-09).

The conference call took place during October 2003 and involved Petersen, Carpenter, James and Anne Hovis, and Phlo's outside attorney (Tr. 109). Anne Hovis spoke for Phlo during most, if not all, of the call (Tr. 110, 141).

Phlo acknowledged that it had received certificates from DTC, but claimed that it did not have to process or return them to DTC (Tr. 109-10). Petersen and Carpenter then asked Anne Hovis if she had any legal grounds for refusing to complete the transfers. Anne Hovis asserted

that DTC was facilitating naked short selling and maintained that Phlo had a duty to protect its shareholders from the negative effects of naked short selling (Tr. 110-12, 129). Petersen and Carpenter explained why, in their judgment, Anne Hovis's position lacked merit (Tr. 111-13, 130). According to Petersen, Anne Hovis did not know what an SCL was, or that transfer agents were subject to federal regulations (Tr. 110). Petersen also opined that Anne Hovis did not appreciate that DTC was the legal owner of the securities that Phlo was refusing to transfer (Tr. 111).

Petersen and Carpenter asked Anne Hovis to work with DTC to resolve the dispute and complete the outstanding transfers (Tr. 112). Anne Hovis stated that she would not do so (Tr. 112). As the conference call continued, Anne Hovis became "loud and somewhat irrational" (Tr. 112). Phlo's outside attorney said nothing at all during the call (Tr. 141). When Petersen and Carpenter could not persuade Anne Hovis to complete the transfers, they stated they would have to follow procedure and refer the matter to OCIE (Tr. 113).

In a subsequent telephone conversation, Anne Hovis told Petersen that Phlo had completed some of the outstanding transfers, but she acknowledged that a large number still remained unprocessed (Tr. 122). Petersen also received a separate follow-up call from James Hovis. He asked Petersen if there was a way of resolving the dispute without referring the matter to OCIE (Tr. 137, 139). The tone of this conversation was somewhat more conciliatory than the conference call, but Petersen reiterated that the turnaround rules required Phlo to complete the transfers (Tr. 136-40).

After James Hovis's call, Petersen checked several times with DTC to learn if there had been any reduction in what Phlo owed DTC, but there had not (Tr. 139). Based on this information and on Anne Hovis's earlier statement to Petersen that the majority of transfers were still outstanding, Petersen and Carpenter referred the matter to OCIE (Tr. 122, 139, 150).

2. Phlo's Failure Promptly to Furnish Records during a Reasonable Examination by the Commission's Staff.

Registered transfer agents must make, keep, and furnish copies of such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act. See Section 17(a)(1) of the Exchange Act.

All records of registered transfer agents (not merely required records) are subject at any time to such reasonable periodic, special, or other examinations by representatives of the Commission as the Commission deems necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act. See Section 17(b)(1) of the Exchange Act.

OCIE Initiates a Cause Examination of
Phlo's Activities as a Transfer Agent

OCIE is the staff office that administers the Commission's nationwide examination and inspection program for registered self-regulatory organizations, brokers, dealers, transfer agents, clearing agencies, investment companies, and investment advisers. OCIE conducts examinations to foster compliance with the securities laws, to detect violations of the law, and to keep the Commission informed of developments in the regulated community. Among the more important goals of the examination program is the quick and informal correction of compliance problems. See http://www.sec.gov/about/offices/ocie.htm (official notice).

Eric Swanson (Swanson) is an attorney and an Assistant Director of OCIE. Swanson supervises the attorneys and examiners who conduct transfer agent examinations (ES Dep. at 6-7). Eric Garvey (Garvey) is an attorney in OCIE. Garvey reports to Swanson on matters concerning transfer agent examinations (Tr. 149).

After OCIE received the referral from the Division of Market Regulation in late October 2003, it initiated a cause examination of Phlo's activities as a transfer agent (ES Dep. at 8; Tr. 150). Cause examinations are triggered by an apparent problem (ES Dep. at 34-35). As a first step, Swanson and Garvey prepared a letter requesting Phlo to provide OCIE with nine categories of documents or information (ES Dep. at 8, 10; Tr. 151-52; DX 2).[16] Swanson signed the letter and Garvey mailed and faxed it to Phlo on October 31, 2003 (ES Dep. at 9; Tr. 151-52; DX 2). Phlo received the letter by facsimile the same day (Answer, Wells Submission at 23).[17]

OCIE's letter gave Phlo until November 7, 2003, to respond (ES Dep. at 10; Tr. 152; DX 2). Phlo did not respond by the due date (ES Dep. at 10-11; Tr. 152-53). Garvey telephoned Anne Hovis on November 7 and 10, 2003, and left messages regarding OCIE's unanswered document request (ES Dep. at 10-11; Tr. 153). Garvey received no return calls from Phlo on those days (ES Dep. at 11; Tr. 153-54).

On November 12, 2003, Anne Hovis left Garvey a voicemail message stating that Phlo was retaining outside counsel, who would contact OCIE within two days (ES Dep. at 12; Tr.

[16] The Division characterizes DX 2 as a "standard letter" (Div. Prop. Find. # 60). It is misleading to suggest that DX 2 was an off-the-rack, one-size-fits-all document request. Swanson explained that DX 2 was "tailored to the issues that we were interested in" examining (ES Dep. at 8). It took "a day or two" for Garvey and Swanson to draft and edit the document request letter (Tr. 151).

[17] At the hearing, Anne Hovis could not remember when Phlo received OCIE's letter (Tr. 25-26). I give greater weight to Respondents' Wells Submission, dated April 15, 2004, than to this hearing testimony. It was prepared closer in time to the underlying event.

154). No one on the OCIE staff ever received a call from outside counsel for Phlo (ES Dep. at 12, 16-17, 25; Tr. 154-55, 158, 161).[18]

Another week passed, during which OCIE heard nothing from Phlo (ES Dep. at 12). Garvey telephoned Anne Hovis again on November 20, 2003, and left another voicemail message (ES Dep. at 12; Tr. 155). Phlo still did not respond (ES Dep. at 12-13; Tr. 155). Phlo's failure to provide any documents or information for OCIE's examination was highly unusual (ES Dep. at 13; Tr. 153-56).

On November 24, 2003, Swanson left two voicemail messages for Phlo: one, with Anne Hovis on her cellular telephone; and another, at Phlo's main telephone number (ES Dep. at 13-14; Tr. 156). Swanson explained that if Phlo did not contact his office by the end of that day, OCIE would initiate a process that could result in revocation of Phlo's registration as a transfer agent (ES Dep. at 13-14, 52).

Anne Hovis promptly returned Swanson's call (Tr. 158). She was upset that OCIE had initiated an examination, which she characterized as retaliation for Phlo's dispute with DTC (ES Dep. at 14; Tr. 307). Swanson informed Anne Hovis that OCIE expected her cooperation. He also told her that he expected to receive the requested documents as soon as possible (ES Dep. at 14-15).

On November 26, 2003, Anne Hovis faxed OCIE a letter seeking a "reasonable" extension of time to respond to the October 31 document request (DX 9) ("taking into account the holidays"). She included a photocopy of a retainer agreement she had just executed with a law firm (ES Dep. at 15; Tr. 158, 160; DX 9). See supra n.18. In her letter, Anne Hovis also claimed that Phlo and DTC had reached an agreement under which Phlo was now completing transfers (Tr. 294, 300; DX 9, DX 13). In fact, Phlo was slowly reducing, but not eliminating, its backlog of unprocessed SCLs (Tr. 79, 322; DX 15).[19]

OCIE did not respond to Phlo's written request for additional time (ES Dep. at 16; Tr. 177). Swanson's rationale for not responding was that Phlo was already overdue (ES Dep. at 16). He also believed that many of the requested documents were routine and should have been easily producible (ES Dep. at 16).

On December 10, 2003, Anne Hovis left voicemail messages for Swanson and Garvey, inquiring about the status of her request for an extension of time (ES Dep. at 17; Tr. 161-63).

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[18] A law firm told Anne Hovis on November 12, 2003, that it would begin work only after Phlo paid a retainer fee (DX 9). Anne Hovis did not accept the law firm's terms until November 25, 2003—nearly two weeks later (DX 9). In these circumstances, it was disingenuous for Anne Hovis to leave Garvey a message on November 12 that the law firm would be contacting OCIE "in about two days" (Tr. 154).

[19] DTC disputed Phlo's view that the controversy had been resolved (Tr. 65, 77, 160). In fact, the controversy still has not been resolved.

Garvey then telephoned Anne Hovis and told her OCIE would not grant an extension (ES Dep. at 17; Tr. 162-63, 177-78). During the December 10 telephone call, Anne Hovis asked Garvey whether OCIE would be performing an on-site examination of Phlo's transfer agent activities (Tr. 163). According to Anne Hovis, Garvey represented that OCIE was not planning to conduct an on-site inspection (Answer at 3; Tr. 309). According to Garvey, he indicated that OCIE was not planning to do so "at this time" (Tr. 163). Later in the same conversation, Anne Hovis told Garvey that Phlo was conducting some transfer agent activities from an office in Washington, D.C. (ES Dep. at 17; Tr. 164-65). The information surprised Swanson and Garvey, who believed that Phlo's transfer agent office was located in Florida (ES Dep. at 17; Tr. 157, 164).

OCIE's Unannounced Visit
to Phlo's K Street Office

After the December 10 telephone conversation, Garvey checked Phlo's transfer agent filings and found that Phlo's original transfer agent registration statement identified an office at 1825 K Street (ES Dep. at 17-18; Tr. 165; DX 15 at Form TA-1). OCIE then decided to make an unannounced visit to Phlo's K Street office on December 12, 2003 (ES Dep. at 18-19; Tr. 166-68).[20]

When Swanson, Garvey, and a third OCIE attorney arrived at the K Street address, they noted that Phlo's name did not appear on the directory of tenants in the lobby of the building. They went upstairs and found an unoccupied, locked suite of offices (ES Dep. at 19-21, 37, 45; Tr. 171-72, 180, 187).[21] Swanson then checked with the receptionist of a pharmaceutical company that occupied a suite of offices down the hallway (ES Dep. at 21-22). The receptionist confirmed that Phlo and the pharmaceutical company shared office space (ES Dep. at 22; Tr. 172). Swanson identified himself as a representative of the Commission and asked to speak with someone from Phlo (ES Dep. at 22; Tr. 172).

James and Anne Hovis were not working at Phlo's K Street office on December 12 (ES Dep. at 22-23; Tr. 209, 326). By happenstance, Hoube, Phlo's vice president of production

[20] Garvey added several clarifications to Swanson's testimony about the purpose of OCIE's December 12 visit to 1825 K Street. According to Swanson, OCIE was conducting a cause examination of Phlo's transfer agent functions (ES Dep. at 18-19, 22). According to Garvey: "[W]e would not have started going through documents at that point. That was not what our intention was. . . . I know we were not planning to actually start reviewing documents. . . . [W]e did not discuss what we were going to do . . . if we got there and there was actually a transfer agent running." (Tr. 167-69).

Swanson testified that he did not authorize Garvey to tell Anne Hovis that OCIE would not conduct an on-site examination, and he did not know that Garvey had done so (ES Dep. at 18-19, 46-47).

[21] OIP ¶ II.C.8 alleges that there was "an empty suite of offices." The office was furnished, but the lights were off and the door was locked (ES Dep. at 21, 37; Tr. 172).

operations in Florida, was visiting the K Street office that day (Tr. 207-08). He was the only person in Phlo's office at the time (Tr. 209). Hoube met the OCIE representatives in the pharmaceutical company's reception area (ES Dep. at 22; Tr. 173). When Swanson asked to see Phlo's transfer agent records, Hoube told Swanson that he was not responsible for maintaining those records and did not know anything about them (ES Dep. at 23; Tr. 209, 213).[22] Hoube then contacted Anne Hovis on her cellular telephone to notify her of OCIE's visit (ES Dep. at 23; Tr. 173, 181, 209-10, 309).

Anne Hovis telephoned Swanson, who was waiting in the pharmaceutical company's reception area (ES Dep. at 23). She was very upset that OCIE wanted to conduct an on-site examination at that time, in light of Garvey's representation only two days earlier (ES Dep. at 23, 42-43; Tr. 309). When Swanson asked Anne Hovis if Phlo's transfer agent records were located at the K Street office, she did not give him a specific answer (ES Dep. at 24). She told Swanson she was not able to be present at the office that day to facilitate OCIE's examination and she declined to allow OCIE to conduct an examination in her absence (ES Dep. at 23-24; Tr. 173, 186, 309). Swanson asked if Anne Hovis could give him a date on which OCIE could come back to conduct an on-site examination and she told him that she could not set a date at that time (ES Dep. at 24; Tr. 309).[23]

After the conversation ended, the OCIE attorneys returned to their office (ES Dep. at 24; Tr. 173). OCIE never heard from Anne Hovis or any attorney representing Phlo thereafter (ES Dep. at 24-25).

OCIE Refers the Matter to the
Division of Enforcement

Shortly after the December 12 visit, OCIE referred the matter to the Division (Tr. 174-75). The Division informed Phlo of its investigation on December 18, 2003 (Answer, Wells Submission at 4).

In a letter dated December 30, 2003, Anne Hovis asked the Division for additional time, until January 16, 2004, to respond to OCIE's October 31, 2003, document request letter (Answer, Exhibit 1 to Wells Submission). As grounds for the extra time, Anne Hovis explained that: (1) she had recently fired her daughter's nanny and she was working only part-time at Phlo

[22] OIP ¶ II.C.8 asserts that Hoube "identified himself as a representative of Phlo's transfer agent." The record establishes that Hoube worked for Phlo in its capacity as an issuer. He also collected the mail in Jacksonville and forwarded it to Washington, D.C. There is no evidence that he performed any substantive work for Phlo its capacity as a transfer agent (ES Dep. at 22-23). There is no evidence that Hoube told OCIE otherwise.

[23] At the hearing, Anne Hovis explained that she was in a public park with her daughter and did not have access to a schedule (Tr. 309, 326). She offered no such explanation to Swanson at the time. Anne Hovis did not contact Swanson later in the day, or on any subsequent day, once she had access to a schedule.

until her daughter started nursery school in January 2004; (2) Phlo lacked other personnel who could assist her during the Christmas holiday season; and (3) numerous other duties demanded her attention (Answer, Exhibit 1 to Wells Submission; Tr. 246, 326). The Division did not respond to Anne Hovis's request for additional time.

On January 15 and 16, 2004, Anne Hovis sent the Division two packages of documents in response to OCIE's October 31, 2003, letter (DX 15, DX 16).[24] Anne Hovis maintained that these materials were fully responsive to OCIE's October 31 request (Tr. 247-48, 308). Swanson considered these submissions to be only partially responsive (ES Dep. at 27-34, 57-58). Anne Hovis believes that the Commission's staff had a duty to inform her during January 2004 if it considered her response to OCIE's letter incomplete (Tr. 271-72, 308; ES Dep. at 60).

DISCUSSION AND CONCLUSIONS

A. Primary Liability

The OIP alleges that Phlo violated Section 13(a) of the Exchange Act and Exchange Act Rules 13a-1 and 13a-13 (OIP ¶ II.E.12). It also alleges that Phlo willfully violated Sections 17A(d)(1) and 17(b)(1) of the Exchange Act and Exchange Act Rules 17Ad-2 and 17Ad-5 (OIP ¶ II.E.10).

Willfulness is shown where a person intends to commit an act that constitutes a violation. There is no requirement that the actor must also be aware that it is violating any statutes or regulations. Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

Untimely Periodic Reports

No showing of scienter is necessary to establish a violation of Section 13(a) of the Exchange Act or the regulations thereunder. See SEC v. McNulty, 137 F.3d 732, 740-41 (2d Cir. 1998); SEC v. Wills, 472 F. Supp. 1250, 1268 (D.D.C. 1978).

The purpose of the periodic reporting requirement is to supply the investing public with current, accurate financial information about an issuer so that the investing public may make informed decisions. As stated in SEC v. Beisinger Indus. Corp., 552 F.2d 15, 18 (1st Cir. 1977) (quoting legislative history):

[24] The Division attaches significance to the fact that Phlo did not deliver the two packages of documents directly to OCIE (Div. Prehear. Br. at 13; Tr. 22, 31; Div. Prop. Find. ## 79, 81; Div. Br. at 33, 35; Div. Reply Br. at 9). Anne Hovis believed that, after December 18, 2003, all communications from Phlo to the Commission's staff should be addressed to the Division, not OCIE (Tr. 23-25, 247, 307; Resp. Reply Br. at 11-12). Once the Division received the documents from Phlo, it promptly forwarded copies to OCIE (ES Dep. at 26, 55). On this issue, the Division elevates form over substance.

> The reporting requirements of the [Exchange Act are] the primary tool which Congress has fashioned for the protection of investors from negligent, careless, and deliberate misrepresentations in the sale of stock and securities. Congress has extended the reporting requirements even to companies which are "relatively unknown and insubstantial."

Phlo's undisputed failure to file timely periodic reports from March 2003 to November 2005 violated Section 13(a) of the Exchange Act and Exchange Act Rules 13a-1 and 13a-13. Respondents insist that there were several mitigating factors, but the record supports only one of these claims.

Respondents first assert that Perry's Majestic Beer/Phlo timely filed all periodic reports for the first five years of the company's existence (Resp. Br. at 1, 16). They then claim that "Phlo had been able to timely file periodic reports for years until its difficulties with various audit firms" (Resp. Reply Br. at 5). These arguments are misleading, at best. James and Anne Hovis did not manage Perry's Majestic Beer/Phlo until December 1998 and may not properly take credit for the actions of prior management. Under Hovis management, Perry's Majestic Beer/Phlo routinely submitted notices of late filing for quarterly and annual reports that were due in 1999, 2000, 2001, and 2002 (Tr. 278).[25] When viewed collectively, these notices demonstrate that the company abused Exchange Act Rule 12b-25.[26] As a result, Respondents cannot credibly claim that Perry's Majestic Beer's/Phlo's periodic reports were "timely" during these four years. Phlo's filing history under Hovis management makes it clear that the company has treated Commission-imposed deadlines as little more than suggestions.

Phlo cannot excuse its failure to file a timely annual report for fiscal year 2003 by blaming its outside auditor. James and Anne Hovis complained that Marcum & Kliegman charged high rates (Tr. 219-20, 279). The argument is both irrelevant and undeveloped. Respondents did not testify about the specific rates charged, nor did they distinguish Marcum &

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[25] Phlo submitted notices of late filing for the periods ended December 31, 1998; March 31, 1999; March 31, 2000; June 30, 2000; September 30, 2000; December 31, 2000; March 31, 2001; June 30, 2001; September 30, 2001; December 31, 2001; March 31, 2002; June 30, 2002; September 30, 2002; and December 31, 2002 (official notice).

Phlo did not submit notices of late filing for the quarters ended June 30, 1999; September 30, 1999; or December 31, 1999. It filed these untimely quarterly reports, as well as its overdue annual report for the fiscal year ended March 31, 1999, on March 23, 2000 (official notice).

[26] In 1980, the Commission adopted a procedure that provides relief with respect to quarterly and annual reports that are not timely filed because of unreasonable effort or expense. See Exchange Act Rule 12b-25. If certain conditions are satisfied, the Commission will deem the reports to be filed on the prescribed due dates. See Exchange Act Rule 12b-25(b). But see Timely Reporting—Final Amendment of Rule and Form, 19 SEC Docket 1072, 1073-74 (Apr. 2, 1980) (final rule) ("In adopting these amendments to Rule 12b-25, the Commission affirms its position that required reports should be filed when due. . . . It should be emphasized that the new notification and relief procedures should not be taken as an excuse for non-timely reporting.").

Kliegman's rates from the rates Phlo subsequently paid to other auditing firms. In any event, Phlo acquiesced in paying Marcum & Kliegman's rates for several years.

The Hovises demonstrated that Marcum & Kliegman became unwilling to continue to allow Phlo to carry an unpaid balance for prior audit and review work (Tr. 220, 273, 279). I see no reason for second-guessing Marcum & Kliegman's business judgment on this matter. Such testimony merely confirms that a creditor with knowledge of Phlo's finances deemed Phlo to be a poor credit risk. Nor is there merit to the Hovises' colorful assertions that Marcum & Kliegman was holding Phlo hostage, shaking down Phlo, and holding a gun to Phlo's head (Tr. 220, 274, 279-80). Marcum & Kliegman explained that it terminated the engagement because Anne Hovis threatened litigation and otherwise interfered with its independence as an auditor (Tr. 265-66; Attachment to Form 8-K/A, dated 7/30/03). I consider Marcum & Kliegman's written explanation to be equally as plausible as the Hovises' testimony. Accordingly, mitigating circumstances have not been established.

Respondents assert that Phlo's next outside auditor, RF&S, acted unreasonably when it insisted that Phlo obtain an independent appraisal of certain intellectual property and technology assets (Resp. Br. at 3). According to the Hovises, Phlo's attorney believed that RF&S had enough evidence to value these assets without an independent appraisal (Tr. 222, 281).

I find this testimony unpersuasive. First, Phlo failed to develop a comprehensive record on the issue. It is unclear if Phlo had prescribed a value for its intangible assets and then asked RF&S to test its valuation method, or if Phlo left the entire valuation process in the hands of RF&S. It is likewise unclear what rationale Phlo's attorney may have invoked for the position the Hovises now attribute to him. Respondents' self-serving testimony was not credible, and they failed to corroborate it with contemporaneous letters or documents. If Phlo's attorney had indeed opined that an appraisal was unnecessary, or if Phlo and RF&S had exchanged correspondence on the subject, those documents should have been offered into evidence. Second, Section 10A(g)(3) of the Exchange Act prohibits registered public accounting firms from providing an issuer with any non-audit service, including appraisal or valuation services, contemporaneously with an audit. Respondents have not shown how RF&S could have lawfully appraised these assets after the effective date of Section 10A(g) (Div. Prop. Find. at 25; Div. Reply Br. at 6 n.7). Third, Phlo did not promptly terminate RF&S and engage another auditor, once it reached an impasse with RF&S on the need for an independent appraisal (Tr. 282) ("We did have sort of a period in limbo after that of a couple of months because we were trying to see if there were a way of handling this."). Finally, Phlo eventually elected not to claim the intangible asset on its balance sheet (Prehearing Conference of June 1, 2005, at 19).

The Division has stipulated that Phlo's next auditor, Sherb, always lacked a sense of urgency, that there were months of inactivity, and that Sherb continually missed deadlines. I will consider that stipulation when assessing sanctions, but the stipulation does not excuse Phlo's violations. No matter how dilatory Respondents felt Sherb was, Phlo retained Sherb as its outside auditor for one year and continued to miss filing deadlines. I will also consider Phlo's efforts to become current in its periodic filings in connection with sanctions.

Section 17A(d)(1) of the Exchange Act

Section 17A(d)(1) of the Exchange Act states that no registered transfer agent shall engage in any activity as a transfer agent in contravention of any Commission rule or regulation. The result is that a violation of the turnaround rules is an automatic violation of Section 17A(d)(1). See Alpha Tech Stock Transfer, 77 SEC Docket 976, 984 (Apr. 1, 2002), final, 77 SEC Docket 1970 (May 13, 2002). A showing of scienter is not required to sustain a violation of Section 17A(d)(1) or the Commission's implementing rules and regulations. Id.

Exchange Act Rule 17Ad-2

When the Hovises registered Phlo as a transfer agent, they obligated the company to comply with the federal transfer agent provisions. The obligations included the central transfer agent duty of turning around at least 90% of all routine items received in a month within three business days.[27]

The Division's evidence demonstrates that Phlo received dozens of SCLs containing transfer requests from DTC from May 30 through October 2, 2003 (DX 15, DX 16, DX 58). Phlo failed to comply with the turnaround rule for any of them. Sixteen SCLs, representing more than 20.4 million shares, remained outstanding through the date of the hearing (Tr. 34-37, 85; DX 40, DX 58).[28]

Respondents argue that the Division failed to show that Phlo turned around less than 90% of all the routine items submitted to it for transfer in any specific month. They observe that Phlo received transfer requests from sources other than DTC, so that Phlo's failure to complete DTC's transfers would not necessarily mean that Phlo failed to satisfy the 90% threshold as to the total number of routine items it received during any given month. On May 29, 2003, Phlo recommended that its shareholders request physical delivery of stock certificates representing their holdings (RX 17). Thereafter, Phlo began to receive transfer requests from brokers and dealers with certificates (Tr. 291; DX 15, DX 16).

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[27] OIP ¶¶ II.B.6 and II.E.10 assume that Phlo was not an "exempt transfer agent," as that term is defined in Exchange Act Rule 17Ad-4(b). Exempt transfer agents do not have to meet the three-business-day turnaround requirement, but only a more lenient five-business-day requirement. See Exchange Act Rule 17Ad-2(e)(2). Phlo has not shown that it ever prepared and maintained a document claiming the exemption. It has waived the opportunity to present such a defense here.

[28] The three-day turnaround period began when Phlo received the items for transfer in Washington, D.C., the premises at which it conducted its transfer agent activities. See supra pp. 8-9. The turnaround period did not begin to run when DTC forwarded the items to Phlo from New York City, or even when Phlo received them at MailBoxes Etc. in Jacksonville. Because Phlo produced incomplete records during the Commission's examination, it is impossible to know exactly when Phlo received the items for transfer in Washington, D.C. Giving Phlo a reasonable amount of time to route the items from Jacksonville to Washington, D.C., Phlo still consistently failed to meet the turnaround requirement.

It is important to appreciate the implications of this argument. As discussed below, transfer agents must make and keep current a schedule or log showing the business day that each item is received from a presentor and made available to a presentor. They must maintain such a schedule or log in an easily accessible place for six months. See Exchange Act Rules 17Ad-6(a)(1) and 17Ad-7(a). Transfer agents must also make and keep current a log or schedule showing for each month the number of routine items received, turned around within three business days of receipt, and not turned around within three business days of receipt. They must maintain such a schedule or log in an easily accessible place for one year. See Exchange Act Rules 17Ad-6(a)(2) and 17Ad-7(b). OCIE requested Phlo to produce these schedules or logs by November 7, 2003 (DX 2, item 4). After more than two months of delays and excuses, Phlo failed to do so (ES Dep. at 27-34; DX 15, DX 16). See infra pp. 25-28.

Unfortunately for Phlo, the documents it did produce show this argument to be frivolous (DX 15, DX 16). Phlo's records show a complete absence of transfer activity during June, July, and August 2003. These are the precise months for which the Division's evidence shows that Phlo received (and still holds) sixteen of DTC's SCLs representing more than 20.4 million shares (DX 40). Phlo also consistently failed to meet the three-day turnaround requirement on requests from presentors other than DTC. In DX 15, Phlo submitted to the Division a document entitled "Phlo Corporation Transfer Agent Activity—Requests for Issuance of Common Stock Certificates." When matched with the corresponding transfer requests Phlo produced in DX 15 and DX 16, these documents demonstrate that Phlo took weeks or months to turn around routine requests for re-registration it received from brokerage firms.[29]

Respondents also contend that DTC somehow "thwarted" Phlo's efforts to comply with the turnaround rules because Phlo could not get instructions from DTC on what to do with the items DTC had presented for transfer. This claim fails for two reasons. First, Phlo's letters to DTC were not legitimate requests for instructions. They were merely requests for the names of beneficial owners, and thus, were a continuation of Phlo's ongoing battle with DTC about who was the legal owner of the securities. In light of the Commission's DTC Rule Approval Order, Phlo's letters could not transform routine items into non-routine items. Second, Phlo repeatedly failed to request instructions from DTC in a timely manner. A transfer agent must decide whether an item is routine or non-routine as soon as it receives the item at its transfer premises. See supra p. 9. Phlo did not notify DTC of its purported need for additional instructions until months after it received the items in question. For example, Phlo's August 21, 2003, letter to DTC requested instructions for SCLs dating back to June 5, 2003; its October 14, 2003, letter to DTC requested instructions for SCLs dating back to June 9, 2003; and its October 16, 2003, letter to DTC requested instructions for SCLs dating back to July 1, 2003 (DX 12). An

[29] The Transfer Timeliness Reports show that Phlo was late on nineteen transfers presented by DTC during June 2003, twenty-nine presented during July 2003, and seven presented during August 2003 (DX 58). To satisfy the 90% turnaround requirement, Phlo would have had to make more than 190 timely transfers to presentors other than DTC during June 2003, 290 timely transfers to presentors other than DTC during July 2003, and seventy timely transfers to presentors other than DTC during August 2003. Phlo's documents do not demonstrate this level of transfer activity.

otherwise routine item does not become non-routine because of internal delays in the turnaround of the item. See supra p. 9.

I conclude that Phlo violated Exchange Act Rule 17Ad-2 by failing to turn around 90% of the routine items DTC presented to it for transfer during the months of June, July, and August 2003.[30] Despite numerous conversations with DTC and warnings from the Division of Market Regulation, the failures continued. In the absence of any colorable legal basis for Phlo's actions, I further conclude that Phlo's violations were willful.

Exchange Act Rule 17Ad-5

Exchange Act Rule 17Ad-5(a) requires a registered transfer agent to respond to any written inquiry concerning the status of an item presented for transfer within the preceding six months. The written inquiry must be specific. Among other things, it must identify the issue, the number of shares presented, the approximate date of presentment, and the name in which the securities are registered. The transfer agent must respond to the written inquiry within five business days of receipt.[31] The response must state whether the item has been received; if received, whether it has been transferred; and if received and not transferred, the reason for the delay and what additional information, if any, is necessary before transfer may be effected.

When any person makes a written inquiry or request that fails to provide all of the information required by Exchange Act Rule 17Ad-5(a), a registered transfer agent must confirm promptly receipt of the inquiry or request and respond to it as soon as possible. See Exchange Act Rule 17Ad-5(g)(1).

The Division alleges that Phlo willfully violated Exchange Act Rule 17Ad-5 by ignoring several Transfer Timeliness Reports that DTC sent during mid-2003 (OIP ¶¶ II.B.6, II.E.10; Div. Prehear. Br. at 18-19). Respondents argue that DTC's Transfer Timeliness Reports were not "inquiries" within the common understanding of that term, and that Phlo had no duty to respond (Resp. Br. at 26).

The text of the rule does not define the term "inquiry." No testimony at the hearing explained its meaning. Geigel, the only witness from DTC, characterized a Transfer Timeliness

[30] The turnaround violations that began during June, July, and August 2003 continued into September 2003. DTC presented no new items to Phlo for transfer between August 22 and October 2, 2003 (DX 58). Phlo completed the transfer of forty items for a brokerage firm on September 30, 2003 (DX 15). It had received these items on various dates in June and July 2003 (DX 16). Phlo failed to meet the three-day turnaround requirement as to any of these items.

[31] The Division contends that a written inquiry requires a written response (Div. Prehear. Br. at 18-19; Tr. 47-48; Div. Prop. Find. at 32). However, Rule 17Ad-5(a) contains no such provision. See Regulation of Transfer Agents, 12 SEC Docket at 862 ("A transfer agent is required to respond, orally or in writing, within five business days after receiving the inquiry."). Transfer agents must keep a telephone log or other similar memorandum if they make oral responses. See Exchange Act Rule 17Ad-6(a)(6).

Report as "a report card" that allows a transfer agent to compare its performance with other transfer agents (Tr. 40). In these circumstances, it is appropriate to give the term "inquiry" its usual meaning. See Black's Law Dictionary 808 (8th ed. 2004) (defining "inquiry" as a request for information") and Webster's Third New Int'l. Dictionary 1167 (1971) (defining "inquiry" as "the act or an instance of seeking truth, information, or knowledge about something" or "a request for information.").

The first page of each Transfer Timeliness Report informed Phlo that: "There are still ___ items outstanding and unresolved" (DX 58). This is a declarative statement, not a request for information. The Transfer Timeliness Report did not ask the recipient to take any action at all. It provided no point of contact (the name, address, and telephone number of anyone at DTC). DTC is a sophisticated institution; if it wanted to generate an "inquiry" to which transfer agents would reply, it had the capacity to do so in plain English.

The information in a report card is a place to begin, not end, an inquiry. A report card may serve as the catalyst for an inquiry. However, a report card is not itself an inquiry. I conclude that the Transfer Timeliness Reports were not "inquiries" within the meaning of Exchange Act Rule 17Ad-5(a).[32]

Failure to Furnish Documents to the Commission's Staff

The Commission's oversight of transfer agents is substantially dependent on its transfer agent examination process, which, in turn, relies on the records that transfer agents make and retain. The Commission's oversight of transfer agents would be seriously hindered if a transfer agent's records were inaccessible. See Recordkeeping Requirements for Transfer Agents, 74 SEC Docket 2281, 2282 (Apr. 27, 2001); cf. SEC v. J.W. Korth & Co., 991 F. Supp. 1468, 1472 n.5 (S.D. Fla. 1998).

Taken together, Sections 17(a)(1) and 17(b)(1) of the Exchange Act require registered transfer agents to furnish records to the Commission when requested. Cf. Silverado Stock Transfer, Inc., 82 SEC Docket 3327, 3329 (May 11, 2004) (settled proceeding); Korth, 991 F. Supp. at 1472. The Commission's authority to access a registrant's books and records is unconditional, subject only to the requirement that any such examination be reasonable. Cf. Interpretive Release Relating to Recordkeeping and Record Production Obligations of National Securities Exchanges and Registered Securities Associations, 18 SEC Docket 670 (Oct. 12, 1979).

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[32] Most of DTC's inquiries to Phlo were made by telephone, not in writing (Tr. 55-60). Before the hearing, the Division's theory was unambiguous: the Transfer Timeliness Reports, by themselves, were the "written inquiries" (Div. Prehear. Br. at 18-19). Perhaps cognizant of the weakness of its position, the Division attempted to shift gears after the hearing. It now suggests a gestalt theory in which the Transfer Timeliness Reports plus DTC's telephonic inquiries plus DTC's November 5, 2003, letter to Phlo collectively constitute a written inquiry for purposes of Rule 17Ad-5 (Div. Prop. Find. at 31-32; Div. Reply Br. at 14). I reject this alternative argument, noting that Phlo responded to DTC's November 5, 2003, letter by telephone and facsimile (DX 11, DX 12, DX 13).

During an examination that began on October 31, 2003, OCIE asked Phlo to provide two types of information by November 7, 2003: (1) records that transfer agents are required by rule to make, keep, and furnish pursuant to Section 17(a)(1) of the Exchange Act; and (2) records that transfer agents are not required to make or keep, but are nonetheless subject to reasonable examination by the Commission pursuant to Section 17(b)(1) of the Exchange Act.[33] Phlo failed to provide any of the requested information until January 15 and 16, 2004. The information that Phlo eventually produced was incomplete in significant respects.

Immediately below, I offer illustrations, but not an exhaustive list, of the types of information that OCIE sought and that Phlo should have been able to provide on extremely short notice.

1. Records that transfer agents are required by rule to make, keep, and furnish. OCIE's letter of October 31, 2003, requested Phlo to submit "copies of any written procedures or instructions involving Phlo's transfer agent activities" (DX 2, item 3). Exchange Act Rule 17Ad-15(c) requires transfer agents to establish written standards for the acceptance of guarantees of securities transfers from eligible guarantor institutions. Exchange Act Rule 17Ad-15(e)(1) mandates that transfer agents keep these written standards and procedures in an easily accessible place so that they may send copies to anyone who requests them within three days of a request. Exchange Act Rules 17Ad-19(b) and (c) require every transfer agent involved in the handling, processing, or storage of securities certificates to establish and implement written procedures for the cancellation, storage, transportation, destruction, or other disposition of such certificates. Exchange Act Rule 17Ad-19(d) requires transfer agents to maintain records that demonstrate compliance with Rule 17Ad-19. For one year, transfer agents must maintain such records in an easily accessible place. Phlo failed to provide copies of such written procedures and instructions (ES Dep. at 28-29, 55-58; DX 15, DX 16).

OCIE's letter of October 31, 2003, also requested Phlo to submit "records, journals, and logs that record daily transfer activities, including when transfer requests are received, when transfers are processed and effected, and the completion of transfers" (DX 2, item 4). Exchange Act Rule 17Ad-6(a)(1) requires registered transfer agents to make and keep current a receipt, ticket, schedule, log or other record showing the business day that each item is received from a presentor and made available to a presentor. Such records must be maintained in an easily accessible place for six months. See Exchange Act Rule 17Ad-7(a). Exchange Act Rule 17Ad-6(a)(2) requires registered transfer agents to make and keep current a log, tally, journal, schedule or other record showing for each month the number of routine items received, turned around within three business days of receipt, and not turned around within three business days or receipt, among other things. Transfer agents must maintain such a log in an easily accessible place for

[33] I agree with the Division that Section 17(b)(1) of the Exchange Act authorizes the Commission to examine all of a registered transfer agent's records, not just those documents the Commission has required the registered transfer agent to create and maintain. Section 3(a)(37) of the Exchange Act defines "records" as including correspondence, memoranda, tapes, discs, papers, and books, among other things.

one year. See Exchange Act Rule 17Ad-7(b). Phlo failed to provide copies of such records, journals, and logs (ES Dep. at 28-29, 55-58; DX 15, DX 16).

2. Records that transfer agents are not required to make and keep, but are nonetheless subject to reasonable examination by the Commission's staff. OCIE's letter of October 31, 2003, requested Phlo to "submit an organization chart for Phlo indicating the names and the number of officials and clerical staff engaged in transfer agent and related activities" (DX 2, item 2). On January 15, 2004, Anne Hovis informed the Division that she was the only such official at Phlo (DX 15). There is no legitimate reason why Phlo could not have provided that information to OCIE by November 7, 2003. OCIE's letter of October 31, 2003, also requested Phlo to "submit copies of all agreements or arrangements between Phlo and [DTC] in effect from July 2002 through the present" (DX 2, item 6). On January 15, 2004, Anne Hovis informed the Division that there were no such agreements (DX 15). At the hearing, the Hovises were adamant that Phlo had refused to sign DTC's standard operating agreement. There is no legitimate reason why Phlo could not have provided a negative response to OCIE by November 7, 2003.

An OCIE-imposed deadline does not necessarily control the reasonableness determination in an adjudicatory proceeding. Here, however, I find that OCIE's deadline of November 7, 2003, was reasonable insofar as it sought the production of documents that the Commission's regulations require a transfer agent to maintain in an easily accessible place, such as items 3 and 4 of DX 2. OCIE's November 7 deadline was also reasonable as to information that Anne Hovis had at the tip of her fingers, such as items 2 and 6 of DX 2.[34] In addition, OCIE demonstrated flexibility and afforded Phlo a grace period after November 7 to respond to its letter. I conclude that Phlo's failure to produce any documents or information for more than two months was sufficiently dilatory as to exceed any notion of reasonableness. Phlo did not cure its violation when it eventually produced some documents on January 15-16, 2004, after the Division had initiated its investigation. Accord, SEC v. Barr Financial Group, Inc., 1999 U.S. Dist. LEXIS 11352 at *6-10 (S.D. Fla. May 5, 1999); Korth, 991 F. Supp. at 1472; Michael Markowski, 51 S.E.C. 553, 554-58 (1993), aff'd, 34 F.3d 99 (2d Cir. 1994).

Phlo has failed to show that OCIE initiated an examination for an improper purpose, namely, to retaliate for Phlo's business dispute with DTC. To prevail on a claim of improper selective prosecution, Respondents must establish that they were singled out for enforcement action while others similarly situated were not, and that their prosecution was motivated by arbitrary and unjust considerations. See United States v. Huff, 959 F.2d 731, 735 (8th Cir. 1992); Barry C. Wilson, 52 S.E.C. 1070, 1074 (1996); Richard J. Puccio, 52 S.E.C. 1041, 1046 (1996).

Phlo's written requests for extra time were not reasonable. Phlo failed to return OCIE's telephone calls of November 7 and 10, 2003, in a timely manner. On November 12, 2003, Anne Hovis told Garvey that Phlo's attorney would be contacting OCIE in a few days, but the evidence demonstrates that Phlo failed even to engage the attorney for nearly two more weeks.

[34] Phlo has never argued that it stored required records at a remote location and needed additional time to retrieve them.

See supra n.18. The Hovises' need for child care, the Christmas holiday season, and the press of other business do not adequately justify Phlo's lengthy delays in supplying the documents and information requested by OCIE. Instead of giving OCIE's request the priority it deserved, Phlo simply shunted it aside. See Robert Fitzpatrick, 76 SEC Docket 252, 257 & n.16 (Oct. 19, 2001); Sundra Escott-Russell, 54 S.E.C. 867, 871 (2000); Wedbush Sec., Inc., 48 S.E.C. 963, 971-72 (1988).

The Division does not argue that Phlo violated Section 17(b)(1) by failing to permit a surprise examination on December 12, 2003. In view of the representations that OCIE made to Anne Hovis on December 10 and the fact that Phlo was short staffed on December 12, this is a prudent position. Rather, the Division contends that Anne Hovis should have promptly contacted Swanson after December 12, 2003, to schedule an in-person examination at Phlo's 1825 K Street office.

OCIE had encountered nothing but dilatory and confrontational responses to its efforts to examine Phlo between November 7 and December 12, 2003. OCIE was under no obligation to continue to chase Phlo after December 12, 2003. I agree with the Division that the responsibility for initiating contact with OCIE after December 12, 2003, rested with Phlo and Anne Hovis.

Likewise, neither the Division nor OCIE was obliged to inform Phlo of the specific deficiencies in its document production on January 15-16, 2004. Respondents assume that charges should not have been brought until they had been afforded an unlimited number of second chances to correct their deficient production. That assumption is unreasonable.

I conclude that Phlo willfully failed to comply with Section 17(b)(1) of the Exchange Act.

B. Secondary Liability

The OIP alleges that James Hovis willfully aided and abetted and caused Phlo's violations of Section 13(a) of the Exchange Act and Exchange Act Rules 13a-1 and 13a-13 (OIP ¶ II.E.13). It also alleges that Anne Hovis willfully aided and abetted and caused Phlo's violations of Sections 17A(d)(1) and 17(b)(1) of the Exchange Act and Exchange Act Rules 17Ad-2 and 17Ad-5 (OIP ¶ II.E.11).

Aiding and Abetting

To show that one respondent willfully aided and abetted the violation of another, the Commission requires the Division to establish three elements: (1) another person has committed a securities law violation; (2) the accused aider and abetter has a general awareness that his or her role was part of an overall activity that was improper or illegal; and (3) the accused aider and abetter knowingly and substantially assisted the primary violation. See Orlando Joseph Jett, 82 SEC Docket 1211, 1256 & n.46 (Mar. 5, 2004); Abraham & Sons Capital, Inc., 75 SEC Docket 1481, 1492 & n.24 (July 31, 2001) (citing Graham v. SEC, 222 F.3d 994, 1000 (D.C. Cir. 2000)); Donald T. Sheldon, 51 S.E.C. 59, 66 (1992), aff'd, 45 F.3d 1515 (11th Cir. 1995).

The Commission has held that a showing of recklessness will satisfy the "substantial assistance" prong of the aiding and abetting test. See Sharon M. Graham, 53 S.E.C. 1072, 1084-85 & n.33 (1998); Russo Sec., Inc., 53 S.E.C. 271, 278-79 & n.16 (1997). One reviewing court has required more. See Howard v. SEC, 376 F.3d 1136, 1143 (D.C. Cir. 2004) (holding that "extreme recklessness" may support aiding and abetting liability, but concluding that "aiding and abetting liability cannot rest on the proposition that the person 'should have known' [that] he was assisting violations of the securities laws.").

Irrespective of the level of proof required to establish the primary violation, the Commission has made clear that the accused aider and abetter must have acted with scienter. See Zion Capital Mgmt. LLC, 81 SEC Docket 3063, 3076-77 & n.35 (Dec. 11, 2003); Terence Michael Coxon, 80 SEC Docket 3288, 3300 n.32 (Aug. 21, 2003), aff'd, 2005 U.S. App. LEXIS 13186 (9th Cir. June 29, 2005); Kingsley, Jennison, McNulty & Morse, Inc., 51 S.E.C. 904, 911 & n.28 (1993).

Phlo's violations of the periodic reporting requirements are clear. It is also clear that James Hovis substantially assisted Phlo's periodic reporting violations and that he did so with an awareness of the firm's wrongdoing.[35] As Phlo's chief executive officer, James Hovis has been responsible for the overall management of Phlo's activities as an issuer. At the relevant times, he has signed Phlo's annual and quarterly reports to the Commission. Under James Hovis's management, Phlo has repeatedly missed the deadlines for filing periodic reports—in six instances, it missed the due dates by more than one year. When disputes arose with outside auditing firms (first, RF&S, and, then, Sherb), James Hovis failed to engage a replacement auditing firm on a timely basis. I conclude that James Hovis's behavior was extremely reckless. I further conclude that James Hovis willfully aided and abetted Phlo's violations of Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder.[36]

Phlo's violations as a transfer agent are equally clear. It is also plain that Anne Hovis substantially assisted Phlo's transfer agent violations, and that she did so with an awareness of the firm's wrongdoing. As Phlo's executive vice president, Anne Hovis has been responsible for Phlo's activities as a transfer agent. When DTC complained to her about Phlo's failure to complete transfers in a timely manner, she ignored DTC. When the Division of Market Regulation counseled Phlo, she failed to cure the ongoing violations. Anne Hovis has been

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[35] I give no weight to the Division's belated claim that James Hovis also aided and abetted Phlo's violations of the rules applicable to transfer agents (Div. Reply Br. at 15-16). The argument is beyond the scope of the OIP.

[36] In so holding, I acknowledge that comparable cases are scarce. I am not aware of any prior proceedings in which the OIP charged an officer of an issuer with willfully aiding and abetting the issuer's non-willful failure to file timely periodic reports. In one pending proceeding, an Administrative Law Judge held the president of an issuer liable for causing the issuer's failure to file timely periodic reports. Cf. Gateway Int'l. Holdings, Inc., 86 SEC Docket ___, ___ (Aug. 18, 2005), review granted. In another proceeding, the Commission held an outside auditor liable for willfully aiding and abetting an issuer's false and misleading periodic reports. See Russell Ponce, 54 S.E.C. 804, 812-13 (2000), aff'd, 345 F.3d 722 (9th Cir. 2003).

unable to articulate a colorable legal basis for Phlo's failure to complete the outstanding transfers. After OCIE contacted Anne Hovis to examine Phlo's records, she put off the staff with a series of delaying tactics and excuses. She never gave the staff's request for access the priority it deserved. After a two-month delay (and after the Division had initiated an investigation), Anne Hovis provided documents that were only partially responsive to OCIE's request. I conclude that Anne Hovis's behavior was extremely reckless. I further conclude that Anne Hovis willfully aided and abetted Phlo's violations of Sections 17A(d)(1) and 17(b)(1) of the Exchange Act and Exchange Act Rule 17Ad-2.

Causing Liability

Section 21C(a) of the Exchange Act specifies that a respondent is a cause of another's violation if the respondent knew or should have known that his or her act or omission would contribute to the violation.

The Commission has determined that causing liability under Section 21C(a) requires findings that: (1) a primary violation occurred; (2) an act or omission by the respondent caused the violation; and (3) the respondent knew, or should have known, that his or her conduct would contribute to the violation. See Robert M. Fuller, 80 SEC Docket 3539, 3545 (Aug. 25, 2003), pet. denied, 2004 U.S. App. LEXIS 12893 (D.C. Cir. Apr. 23, 2004); Erik W. Chan, 77 SEC Docket 851, 859-60 (Apr. 4, 2002).

Negligence is sufficient to establish liability for causing a primary violation that does not require scienter. Howard, 376 F.3d at 1141; KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1175 (2001), recon. denied, 74 SEC Docket 1351 (Mar. 8, 2001), pet. denied, 289 F.3d 109 (D.C. Cir. 2002). Negligence is the failure to exercise reasonable care or competence. Byron G. Borgardt, 80 SEC Docket 3559, 3577 & n.35 (Aug. 25, 2003).

In Dominick & Dominick, Inc., 50 S.E.C. 571, 578 n.11 (1991), a settled proceeding, the Commission concluded that one who aids and abets a primary violation is necessarily a cause of the violation. The Commission has subsequently followed that approach in contested cases raising the same issue. See Abraham & Sons, 75 SEC Docket at 1492 & n.25; Graham, 53 S.E.C. at 1085 n.35; Adrian C. Havill, 53 S.E.C. 1060, 1070 n.26 (1998). I have followed the rationale of these decisions here. Even if James Hovis were to be absolved of willfully aiding and abetting Phlo's periodic reporting violations, he surely caused them. Cf. Gateway.

C. Affirmative Defenses

Respondents argue that DTC interfered with Phlo's efforts to comply with its obligations as a transfer agent. Among other things, they claim that DTC: (1) refused to recognize Phlo as the transfer agent for its own shares for six months (July to December 2002); (2) attempted to force Phlo to sign a standard operating agreement that the Hovises found objectionable; (3) failed to provide Phlo with detailed transfer instructions in response to Phlo's letter of February 4, 2003 (DX 15); (4) failed to honor Phlo's change of address from Budd Lake to Jacksonville (May 2003); (5) failed to issue an Important Notice to participants after receiving Phlo's letter of June

5, 2003;[37] and (6) interfered with a lawful net revenue interest dividend transaction between Phlo and its shareholders after September 18, 2003.

Assuming that every one of these grievances is meritorious—an extremely dubious assumption—the problems between Phlo and DTC are irrelevant to the issues presented for decision. The Division has not alleged that Phlo violated the turnaround rules with respect to items presented before June 2003 or after September 2003. None of these problems supports an inference that DTC interfered with Phlo's ability to comply with the turnaround rules during June, July, and August 2003—the period in which Phlo's violations occurred. Phlo did not even announce its net revenue interest dividend program until September 18, 2003 (RX 18). By that time, Phlo's violations of Rule 17Ad-2 were complete.

The Division's "failure" to investigate DTC's purported misconduct is not properly before me. Decisions not to enforce are presumptively unreviewable. Heckler v. Chaney, 470 U.S. 821, 831-35 (1985); Chicago Bd. Of Trade v. SEC, 883 F.2d 525, 530-31 (7th Cir. 1989); cf. Kixmiller v. SEC, 492 F.2d 641, 644-45 (D.C. Cir. 1974). The presumption may be rebutted where the substantive statute has provided guidelines for the agency to follow in exercising its enforcement powers. Chaney, 470 U.S. at 832-33. However, that is not the situation presented here. DTC's conduct does not extinguish Phlo's violations, nor does it mitigate the appropriate sanctions.

Respondents also assert that: (1) DTC's electronic clearance system facilitates naked short selling; (2) the Commission's staff has taken action to shield DTC from criticism; and (3) this ongoing conspiracy has harmed public companies and the shareholders that the Commission was created to protect. The record shows that such views are strongly held by some shareholders and some small issuers (RX 12, RX 13, RX 14, RX 15, RX 17). It does not show that these views are meritorious, or even relevant here.[38] The issues associated with naked short selling arise in the context of trading and not in the book-entry transfer of securities.

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[37] DTC told the Commission that, upon receipt of a withdrawal request from an issuer, it would issue an Important Notice notifying its participants of the receipt of the withdrawal request from the issuer and reminding participants that they could utilize DTC's withdrawal procedures if they wished to withdraw their securities from DTC. See DTC Rule Approval Order, 80 SEC Docket at 1310. However, after receiving Phlo's letter of June 5, 2003, DTC failed to issue such an Important Notice regarding Phlo (Tr. 90-93, 361-62; Letter from Geigel to ALJ, dated Sept. 29, 2005).

[38] Naked short sellers have become convenient scapegoats in recent adjudicatory proceedings involving misconduct that is related to the securities of small issuers.

One recent proceeding sought to revoke an issuer's securities because the issuer had not filed periodic reports in more than four years. The issuer did not dispute its failure to file. Rather, it defended on the grounds that its business plan and its finances had been impaired by naked short sellers who had driven down the price of its stock. The issuer represented that it had filed a civil action against the naked short sellers and that, once it won a verdict and collected a judgment, it would have more than enough cash to revive its business plan and make its overdue

SANCTIONS

The proven violations involve serious misconduct. Phlo has recently cured its periodic reporting violations, and the Division has stipulated to a mitigating circumstance involving one outside auditing firm. The sanctions imposed for the periodic reporting violations reflect these considerations.

In contrast, Phlo's violations of the turnaround rules and its failure to cooperate with an OCIE examination are ongoing. There are no mitigating circumstances and several aggravating circumstances. Congress directed the Commission to use its authority under the Exchange Act to end the physical movement of securities certificates in connection with settlement of securities transactions. See Section 17A(e) of the Exchange Act. Here, however, the record supports an inference that Phlo used its status as a registered transfer agent to wage a guerilla war: it wanted to make the electronic clearance of transactions in its common stock a practical impossibility. The sanctions imposed for Phlo's transfer agent violations are significantly more severe.

Revoking the Registration of Phlo's Securities

The Division seeks to revoke the registration of Phlo's securities (OIP ¶ III.D; Div. Prehear. Br. at 28-30; Div. Prop. Find. at 45-46; Div. Reply Br. at 17-18).[39]

Under Section 12(j) of the Exchange Act, the Commission is authorized, "as it deems necessary or appropriate for the protection of investors," to revoke the registration of a security or to suspend the registration of a security for a period not exceeding twelve months, if it finds

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periodic filings. The defense was not successful before the Administrative Law Judge. See Eagletech Communications, Inc., 85 SEC Docket 2459, 2462-63 (June 7, 2005), review granted.

In another recent proceeding, a stock promoter was charged with manipulating upward the price of a penny stock in violation of the antifraud provisions of the securities laws. Among his defenses, the promoter alleged that a cabal of naked short sellers had been depressing the price of the security. Instead of bringing his evidence to the attention of the Commission, the NASD, or another law enforcement agency, the promoter decided to "fight the shorts" by raising the price of the security. This defense was not successful before the Administrative Law Judge, either. See Vladlen "Larry" Vindman, 85 SEC Docket 1928, 1940-41 (May 24, 2005), review granted.

[39] Phlo's most recent quarterly and annual reports state that the company has issued several classes of securities: common stock, warrants, Series A convertible preferred stock, Series B non-convertible preferred stock, and Series C convertible preferred stock. Only one of these classes—Phlo's common stock—is registered with the Commission (OIP ¶ II.A.1). The Division has made clear that its request for relief under Section 12(j) is confined to Phlo's common stock (Order Revising Briefing Schedule and Identifying Issues to be Addressed, dated Nov. 3, 2005; Letter to ALJ from Division counsel, dated Nov. 18, 2005).

that the issuer of such security has failed to comply with any provision of the Exchange Act or the rules and regulations thereunder.[40]

Several initial decisions have analyzed the appropriateness of revocation under Section 12(j) of the Exchange Act by reference to the public interest factors identified in Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981). See, e.g., Neurotech Development Corp., 84 SEC Docket 3938, 3941 (Mar. 1, 2005), final, 85 SEC Docket 1600 (May 16, 2005).

Phlo's periodic reporting violations were very serious and involved important regulatory provisions. The violations were ongoing for more than two years. Scienter is not an element of the violations. Respondents offer no assurances against future violations. They fail to recognize the wrongful nature of their conduct and seek to blame a series of outside auditors. While the likelihood of future violations cannot be discounted, Phlo is now current in its financial reporting obligations.

In e-Smart Technologies, Inc., 83 SEC Docket 3586, 3592 (Oct. 12, 2004) (Order Remanding Proceeding), the Commission stated that an issuer's subsequent filing history is an important factor to be considered in determining whether revocation is necessary or appropriate for the protection of investors. Phlo is entitled to credit for becoming current, even if it did not begin to take its filing obligations seriously until after the Division began to investigate. Phlo is also entitled to the benefit of the Division's stipulations about Sherb.

Now that Phlo is current in its financial reporting, its Forms 10-KSB and 10-QSB can speak for themselves. The investing public has timely information to determine the pros and cons of buying, selling, or holding Phlo's common stock. After weighing the relevant considerations, I conclude that Phlo can be adequately sanctioned for its periodic reporting violations by a cease-and-desist order, as addressed below.

The academic literature considers revocation under Section 12(j) to be a harsh sanction. See 2 Thomas Lee Hazen, Treatise on the Law of Securities Regulation § 9.2[1][B] (4th ed.

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[40] The statutory language is far broader than the OIP. Section 12(j) envisions revocation if an issuer failed to comply with any provision of the Exchange Act. In contrast, the OIP contemplates revocation only for Phlo's periodic reporting violations (OIP ¶ III.D). In other words, the Division has crafted the OIP so that Phlo's proven violations of the turnaround rules and its failure to cooperate with a reasonable examination by the Commission's staff cannot be considered.

This is a curious choice, because previous proceedings have revoked an issuer's securities for reasons other than (or in addition to) periodic reporting violations. See, e.g., NorthStar Network, Inc., 78 SEC Docket 1040 (Aug. 21, 2002) (antifraud violations, failure to maintain accurate books and records, failure to maintain an adequate system of internal accounting controls) (settled proceeding); Countryland Wellness Resorts, Inc., 74 SEC Docket 44 (Jan. 3, 2001) (antifraud violations) (settled proceeding).

2002) ("It will require serious violations to lead the SEC to conclude that eliminating a public market for the securities best serves the interest of investors."); 4 Louis Loss & Joel Seligman, Securities Regulation 1892 (3d ed., rev. vol. 2000) (opining that involuntary revocation of a security's registration is draconian, harmful to innocent security holders, and unnecessary because other regulatory tools are available to the Commission to ensure the filing of adequate reports).

Revocation or suspension would be punitive. It is not necessary or appropriate to protect investors. I deny the Division's request to sanction Phlo under Section 12(j) of the Exchange Act.

Cease-and-Desist Orders

Section 21C(a) of the Exchange Act authorizes the Commission to impose a cease-and-desist order upon any person who "is violating, has violated, or is about to violate" any provision of the Exchange Act or the rules and regulations thereunder. The Commission may also impose a cease-and-desist order against any person that "is, was, or would be a cause of [a] violation" due to an act or omission the person "knew or should have known would contribute to such a violation."

In KPMG, 54 S.E.C. at 1183-92, the Commission addressed the standard for issuing cease-and-desist relief. It explained that the Division must show some risk of future violations. However, it also ruled that such a showing should be "significantly less than that required for an injunction" and that, absent evidence to the contrary, a single past violation ordinarily suffices to raise a sufficient risk of future violation. Id. at 1185, 1191.

Along with the risk of future violations, the Commission considers the seriousness of the violation, the isolated or recurrent nature of the violation, the respondent's state of mind, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the respondent's opportunity to commit future violations. Id. at 1192. In addition, the Commission considers whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceeding. Id. The Commission weighs these factors in light of the entire record, and no one factor is dispositive.

The U.S. Court of Appeals for the District of Columbia Circuit has insisted that the Commission adhere to the standards it announced in KPMG. See WHX Corp. v. SEC, 362 F.3d 854, 859-60 (D.C. Cir. 2004) (rejecting the Commission's explanation of the risk of future violations and vacating a cease-and-desist order).

The Division seeks cease-and-desist orders against all three Respondents (OIP ¶ III.C; Div. Prehear. Br. at 26-27; Div. Prop. Find. at 43-44). Although Respondents contested liability, they did not specifically oppose cease-and-desist relief if liability was established (Resp. Br. at 15-19, 32-34; Resp. Reply Br. at 16-20).

Addressing the KPMG factors here, I incorporate by reference my evaluation of Phlo's periodic reporting violations, discussed immediately above. I also conclude that James Hovis acted with extreme recklessness. The periodic reporting violations ended only recently. Harm to investors and the marketplace is not quantifiable. However, the investing public was deprived of information critical to a full understanding of Phlo's financial status for more than two years. After weighing these factors, I conclude that cease-and-desist orders are plainly warranted as to Phlo and James Hovis.

Phlo's violations of the turnaround rules and Section 17(b)(1) were egregious and involved important regulatory provisions. The violations can hardly be described as isolated infractions. In some instances, they have been ongoing from June 2003 to the present. Scienter is not an element of any of the primary violations. However, Anne Hovis deliberately disregarded her responsibilities as the officer responsible for Phlo's activities as a transfer agent. Phlo and Anne Hovis do not recognize the wrongful nature of their conduct. In fact, Respondents have made a clear effort to deflect any and all blame to others, including DTC, naked short sellers, and members of the Commission's staff. The violations are relatively recent. There is no quantifiable harm to investors. However, Phlo's violations of the turnaround rules deprived DTC's nominee and investors of the shares they owned. The violations also interfered with the safety and efficiency of the national clearance and settlement system. I infer that future violations are quite likely to occur. I will therefore impose cease-and-desist orders as to Phlo and Anne Hovis for all proven violations.

Revoking Phlo's Registration as a Transfer Agent;
Barring Anne Hovis from Associating with a Transfer Agent

The Division next seeks to revoke Phlo's registration as a transfer agent and to bar Anne Hovis from associating with any transfer agent (OIP ¶ III.B; Div. Prehear. Br. at 24-26; Div. Prop. Find. at 41-43; Div. Reply Br. at 17-18). It does not seek an associational bar against James Hovis.

Section 17A(c)(3)(A) of the Exchange Act, in conjunction with Section 15(b)(4)(D) of the Exchange Act, allows the Commission to censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of a transfer agent. The Commission must determine that such action is in the public interest. As here relevant, it must also determine that the transfer agent is subject to an order or finding that it has willfully violated the Exchange Act or the rules and regulations thereunder.

Section 17A(c)(4)(C) of the Exchange Act, in conjunction with Section 15(b)(4)(E) of the Exchange Act, authorizes the Commission to censure, place limitations on the activities or functions of, suspend for a period not exceeding twelve months, or bar any person from being associated with a transfer agent. The Commission must determine that such action is in the public interest. It must also determine that the person is subject to an order or finding that he or she has willfully aided and abetted a violation of the Exchange Act or the rules and regulations thereunder.

I incorporate here the Steadman analysis offered above in connection with the need for cease-and-desist orders against Phlo and Anne Hovis. I also note that the Commission has recently revoked the registration of an investment adviser and barred the president of that firm from associating with an investment adviser for failing to cooperate with a Commission examination. See Schield Mgmt. Co., Exchange Act Release No. 53201 at 15 & n.48, 2006 SEC LEXIS 195 at *36 & n.48 (Jan. 31, 2006) (finding that the failure to cooperate with a Commission examination constitutes serious misconduct justifying strong sanctions).

I conclude that the public interest requires the revocation of Phlo's registration as a transfer agent.[41] I further conclude that the public interest requires that Anne Hovis be barred from associating with any transfer agent.

Civil Monetary Penalties

In any proceeding instituted pursuant to Section 17A of the Exchange Act, the Commission may assess a civil monetary penalty against any person who has willfully violated or willfully aided and abetted any violations of the Exchange Act or the rules and regulations thereunder. See Section 21B(a) of the Exchange Act. The Commission must find that such a penalty is in the public interest. Six factors are relevant to the public interest determination: (1) fraud, or the deliberate or reckless disregard of a regulatory requirement; (2) harm to others; (3) unjust enrichment; (4) prior violations; (5) deterrence; and (6) such other factors as justice may require. See Section 21B(c) of the Exchange Act.[42] Not all factors may be relevant in a given case, and the factors need not all carry equal weight.

No civil penalty is possible against Phlo for the periodic reporting violations. As here relevant, the Commission instituted this proceeding against Phlo pursuant to Sections 12(j) and 17A of the Exchange Act (OIP ¶ I). A civil penalty is not a permissible remedy for a proceeding instituted pursuant to Section 12(j). See Section 21B(a) of the Exchange Act; see also e-Smart, 83 SEC Docket at 3593 n.17 (identifying the range of possible sanctions). A civil penalty is a permissible remedy for a proceeding instituted pursuant to Section 17A, but only if the underlying violation is willful. See Section 21B(a)(1) of the Exchange Act. The OIP does not allege that Phlo's periodic reporting violations were willful (OIP ¶ II.E.12).

The situation is different with respect to James Hovis. As here relevant, the Commission instituted this proceeding against James Hovis pursuant to Section 17A of the Exchange Act (OIP ¶ I). The OIP alleged, and the Division proved, that James Hovis willfully aided and

[41] Compliance with this order, and the accompanying cease-and-desist order, will require Phlo to engage a successor transfer agent, acceptable to the Division and OCIE, within five days after the effective date of this Initial Decision. Compliance will also require Phlo and the successor transfer agent to complete the transfer of all the pending items that are the subject of this proceeding within ten days after the effective date of this Initial Decision.

[42] On January 4, 2006, after the parties had completed the post-hearing briefing in this matter, the Commission issued a Statement Concerning Financial Penalties. See Press Release No. 2006-04. I have given due regard to that policy statement in assessing Phlo's civil penalty here.

abetted Phlo's periodic reporting violations (OIP ¶ II.E.13). As a result, the Division has satisfied both of the predicates for imposing a civil penalty against James Hovis under Section 21B(a)(2) of the Exchange Act. There is no nexus between Phlo's violations as an issuer and James Hovis's status as a person associated with a registered transfer agent. However, Section 21B(a) does not require the Division to prove such a nexus.[43] The Division has not argued that James Hovis's willfulness should be imputed to Phlo.

Section 21B(b) of the Exchange Act specifies a three-tier system identifying the maximum amount of a penalty. All of the violations in this proceeding occurred after February 3, 2001, and nearly all of them occurred before February 15, 2005.[44] For each such "act or omission" by a corporation, the adjusted maximum amount of a penalty is $60,000 in the first tier and $300,000 in the second tier. For each such "act or omission" by a natural person, the adjusted maximum amount of a penalty is $6,500 in the first tier and $60,000 in the second tier.

The Division seeks second-tier civil penalties of $300,000 against Phlo, $60,000 against James Hovis, and $60,000 against Anne Hovis (OIP ¶ III.B; Div. Prehear. Br. at 22-24; Div. Prop. Find. at 40-41; Div. Reply Br. at 15-17). A second-tier penalty is permissible if the act or omission involved the deliberate or reckless disregard of a regulatory requirement.

The adjusted statutory maximum amount is not an overall limitation, but a limitation per violation. See Mark David Anderson, 80 SEC Docket 3250, 3270 (Aug. 15, 2003) (imposing a civil penalty of $1,000 for each of the respondent's ninety-six violations); cf. United States v. Reader's Digest Ass'n, 662 F.2d 955, 966, 970 (3d Cir. 1981) (holding that each individual mailing constitutes a separate violation of an FTC consent order). As shown below, the penalties sought by the Division are well within the statutory ceiling.

Phlo committed a separate violation each time it failed to meet the deadline for filing a periodic report. Thus, James Hovis willfully aided and abetted eleven separate violations (three annual and eight quarterly reports). Because James Hovis recklessly disregarded a regulatory requirement, a second-tier penalty is permissible.

Each of the three months that Phlo failed to satisfy the 90% turnaround rule constituted a separate violation of Exchange Act Rule 17Ad-2. These violations demonstrated deliberate disregard of a regulatory requirement. Accordingly, second-tier penalties are appropriate as to Phlo and Anne Hovis.

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[43] The Commission has jurisdiction to impose civil penalties against the individual Respondents even though they are not registrants. I reject Respondents' argument to the contrary (Resp. Br. at 33; Resp. Reply Br. at 16).

[44] As required by the Debt Collection Improvement Act of 1996, the Commission increased the maximum penalty amounts for violations occurring after December 6, 1996, and, again, for violations occurring after February 2, 2001. See 17 C.F.R. §§ 201.1001, .1002. For purposes of calculating the maximum permissible penalties, I will treat the violations as occurring before February 15, 2005 (Div. Prop. Find. at 41 n.22). See 17 C.F.R. § 201.1003. For all other purposes, the Division urges me to treat the violations as ongoing.

Phlo's failure to furnish records to the Commission's staff during a cause examination constituted a single, ongoing violation of Section 17(b)(1) of the Exchange Act. Accord Korth, 991 F. Supp. at 1473 & n.8. The violation began on November 7, 2003; continued through January 15-16, 2004; and is still ongoing. Because Phlo and Anne Hovis recklessly disregarded a regulatory requirement, second-tier penalties are appropriate.[45] Anne Hovis's failure to contact Swanson after December 12, 2003, to schedule an on-site examination at Phlo's 1825 K Street office constituted a second, separate tier-two violation.

Addressing the six factors that guide the public interest analysis under Section 21B of the Exchange Act, I have concluded that the proven violations involved the reckless disregard of the periodic reporting requirements, and the deliberate disregard of the turnaround rules and the duty to furnish records to the Commission's staff. Respondents have not been unjustly enriched. There is no quantifiable harm to others. There are no prior violations. The record demonstrates that other issuers may be considering a move to certificate-only clearing and/or becoming transfer agents for their own shares (Tr. 132, 185; RX 12, RX 13, RX 14, RX 15, RX 17). It is important that these issuers do so in conformity with all the applicable statutes and regulations. The need for deterring misconduct by others is thus strong. Finally, Section 17A(e) of the Exchange Act directs the Commission to use its authority under the Exchange Act to end the physical movement of securities certificates. That is a matter that justice requires me to consider.

Respondents assert that civil monetary penalties imposed against persons associated with transfer agents in settled proceedings have been lower than the amount the Division seeks to impose against Anne Hovis here (Resp. Reply Br. at 17-18). However, it is well established that respondents who offer to settle may properly receive lesser sanctions than they otherwise might have received based on pragmatic considerations such as the avoidance of time-and-manpower-consuming adversary proceedings. See Stonegate Sec., Inc., 76 SEC Docket 111, 118 & n.21 (Oct. 15, 2001) (collecting cases).

I conclude that Phlo should be assessed a civil penalty of $100,000; James Hovis, a civil penalty of $25,000; and Anne Hovis, a civil penalty of $50,000.

No Evidence of Inability to Pay

Under Section 21B(d) of the Exchange Act, in any case in which the Commission may impose a civil penalty, a respondent may present evidence of the respondent's ability to pay the penalty. The Commission may, in its discretion, consider such evidence in determining whether a civil penalty is in the public interest. Such evidence may relate to the extent of the

[45] In Barr, 1999 U.S. Dist LEXIS 11352 at *14-16, the district court found that the tier-two criteria were "not clearly established" because the defendants "merely argued for a strained interpretation of fact and law." Barr is distinguishable from this proceeding. The Division is not required to make its case for sanctions by clear and convincing evidence; a preponderance of the evidence is sufficient. In addition, Phlo, unlike Barr, was not simply offering a strained interpretation of fact and law.

respondent's ability to continue in business and the collectability of the penalty, taking into account any other claims of the United States or of third parties on the respondent's assets and the amount of the respondent's assets.

Well before the hearing, I advised Respondents that, if they intended to claim inability to pay civil penalties, they were required to provide appropriate financial disclosure (Prehearing Conference of June 1, 2005, at 30-32, 43; Scheduling Order of June 2, 2005). See Rule 630 of the Commission's Rules of Practice; Terry T. Steen, 53 S.E.C. 618, 626-28 (1998) (holding that an ALJ may require the filing of sworn financial statements). Respondents did not provide appropriate financial disclosure and the Division did not have an opportunity to question them about their financial circumstances. I conclude that James and Anne Hovis have waived any claim of inability to pay. Phlo's financial circumstances may be gleaned from its most recent audited annual reports. Its ability to continue in business after paying a $100,000 penalty is apparent from the salary it has paid James Hovis while the violations occurred.

RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, I certify that the record includes the items set forth in the record index issued by the Secretary of the Commission on December 12, 2005.

ORDER

Based on the findings and conclusions set forth above:

IT IS ORDERED THAT, pursuant to Section 21C of the Securities Exchange Act of 1934, Phlo Corporation shall cease and desist from committing or causing any violations or future violations of Sections 13(a), 17A(d)(1), and 17(b)(1) of the Securities Exchange Act of 1934 and Exchange Act Rules 13a-1, 13a-13, and 17Ad-2; and

IT IS FURTHER ORDERED THAT, pursuant to Section 21C of the Securities Exchange Act of 1934, James B. Hovis shall cease and desist from committing or causing any violations or future violations of Section 13(a) of the Securities Exchange Act of 1934 and Exchange Act Rules 13a-1 and 13a-13; and

IT IS FURTHER ORDERED THAT, pursuant to Section 21C of the Securities Exchange Act of 1934, Anne P. Hovis shall cease and desist from committing or causing any violations or future violations of Sections 17A(d)(1) and 17(b)(1) of the Securities Exchange Act of 1934 and Exchange Act Rule 17Ad-2; and

IT IS FURTHER ORDERED THAT, pursuant to Section 17A of the Securities Exchange Act of 1934, the registration of Phlo Corporation as a transfer agent shall be revoked; and

IT IS FURTHER ORDERED THAT, pursuant to Section 17A of the Securities Exchange Act of 1934, Anne P. Hovis shall be barred from associating with any registered transfer agent; and

IT IS FURTHER ORDERED THAT, pursuant to Section 21B of the Securities Exchange Act of 1934, Phlo Corporation shall pay a civil penalty of $100,000; James B. Hovis shall pay a civil penalty of $25,000; and Anne P. Hovis shall pay a civil penalty of $50,000.

Payment of the civil penalties shall be made on the first day following the day this Initial Decision becomes final. Payment shall be made by wire transfer, certified check, United States Postal money order, bank cashier's check, or bank money order, payable to the Securities and Exchange Commission. The payments, and a cover letter identifying the Respondents and the proceeding designation, shall be delivered to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, Virginia 22312. A copy of the cover letter and the instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision pursuant to Rule 111 of the Commission's Rules of Practice. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact.

The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact, or unless the Commission determines on its own initiative to review this Initial Decision as to any party. If any of these events occur, the Initial Decision shall not become final as to that party.

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James T. Kelly
Administrative Law Judge