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**UNITED STATES DISTRICT COURT
DISTRICT OF NEVADA**

**UNITED STATES SECURITIES AND
EXCHANGE COMMISSION,**

Plaintiff,

v.

CHESTER E. HOWARD,

Defendant.

Case No.

**COMPLAINT FOR VIOLATIONS OF
THE FEDERAL SECURITIES LAWS**

Plaintiff Securities and Exchange Commission (“Commission”) alleges as follows:

JURISDICTION AND VENUE

1. This Court has jurisdiction over this action pursuant to Sections 21(d)(1), 21(d)(3)(A), 21(e) and 27 of the Securities Exchange Act of 1934 (“Exchange Act”), 15 U.S.C. §§ 78u(d)(1), 78u(d)(3)(A), 78u(e) & 78aa. Defendant has, directly or indirectly, made use of the means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange, in connection with the transactions, acts, practices, and courses of business alleged in this Complaint.

2. Venue is proper in this district pursuant to Section 27 of the Exchange Act, 15 U.S.C. § 78aa, because certain of the transactions, acts, practices, and courses of conduct constituting violations of the federal securities laws occurred within this district and because the defendant resides within this district.

SUMMARY OF ALLEGATIONS

3. This action involves a financial fraud perpetrated by Chester E. (“Chet”) Howard, who at the time was the Chief Executive Officer (“CEO”) and Acting Chief Financial Officer (“CFO”) of AXM Pharma, Inc. (“AXM”), which was a publicly traded pharmaceutical company that sold products in The People’s Republic of China (“PRC”), Hong Kong, and Taiwan. For the quarter ended June 30, 2005, at Howard’s direction, AXM fraudulently recognized approximately \$2.8 million in revenue from a series of purchase orders for Sunkist-licensed products from distributors in Asia before payment was reasonably assured and before some of the products were delivered. As a result, AXM’s reported revenue of approximately \$3.2 million was fraudulently overstated by \$2.8 million, or approximately 700 percent, and AXM’s net income was falsely reported as approximately \$179,000. In fact, AXM’s actual revenue for the quarter was approximately \$329,000, and it had a net loss of approximately \$1.46 million. AXM recognized and reported the \$2.8 million of revenue on the basis of the purchase orders, even though several of the criteria for revenue recognition under Generally Accepted Accounting Principles (“GAAP”) were not met. On October 31, 2005, AXM announced that it should not have recognized the \$2.8 million of revenue during the second quarter of 2005 and would restate its quarterly results.

4. Howard approved an AXM press release, dated July 18, 2005, which fraudulently reported that AXM had “shipped and booked sales in excess of \$3.1 million in the second quarter and expects to post a quarterly profit.” The press release further stated that “sales of approximately US\$2.8 million of Sunkist products were achieved in the Hong

Kong, Shanghai and Taiwan markets during June 2005.” Howard helped draft, approved, signed, and certified the accuracy of AXM’s second quarter Form 10-Q, dated August 15, 2005, which included financial statements that were fraudulently overstated by the improperly recognized revenue and presented a false and misleading report of the results of AXM’s operations. Howard also approved a press release, dated August 15, 2005, that materially misrepresented AXM’s business and financial results, and participated in an August 15, 2005 conference call with investors in which he falsely reported that AXM had record revenue during the quarter. At the time Howard approved the press releases, signed and certified the Form 10-Q, participated in the conference call, and signed the Forms 8-K to which the press releases and transcript of the conference call were attached, Howard knew, or was reckless in not knowing, that AXM’s financial statements were materially false and misleading.

5. Howard violated the antifraud, certification, books and records, and false statements to accountant provisions of the federal securities laws, and aided and abetted AXM’s violations of the reporting, record-keeping, and internal controls provisions of the Exchange Act. The Commission requests that the Court permanently enjoin Howard from future violations of these provisions, order Howard to pay a civil penalty, and bar Howard from serving as an officer or director of any public company.

THE DEFENDANT

6. Chester E. (“Chet”) Howard, is a resident of Las Vegas, Nevada. Howard joined AXM in March 2004 as its CFO. In February 2005, Howard was promoted to CEO, and remained acting CFO. During his tenure in 2005, Howard signed AXM’s filings with the Commission as CEO and Acting CFO or Acting Principal Accounting Officer. Howard resigned from AXM in October 2005. Howard received a Bachelor’s Degree in Business Administration with a major in Accounting and a Masters in Business Administration from

California State Polytechnic University, and attended numerous seminars to maintain current expertise in SEC reporting and other corporate governance matters. Before joining AXM, Howard served as an officer and CFO of various public companies. From January 2000 until he joined AXM in 2004, Howard was a consultant who specialized in Commission reporting and compliance with the Sarbanes-Oxley Act of 2002.

RELEVANT ENTITY

7. AXM Pharma, Inc. is a Nevada corporation. At the time of the conduct alleged herein, its principal executive offices were located in Las Vegas Nevada, AXM's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act, 15 U.S.C. § 78l(b), and AXM's common stock was listed on the American Stock Exchange. AXM's business was the sale of over-the-counter and prescription pharmaceutical products in the PRC. AXM also had a license to distribute Sunkist co-branded products in Hong Kong, Taiwan, and Shanghai, as well as other areas of Asia.

FACTS

8. Prior to 2002, AXM produced and sold pharmaceutical products which it manufactured at a factory located in the PRC. In 2002, due to Chinese regulatory requirements, AXM shut down its factory and began construction of a new factory. AXM's revenue declined during construction of its new manufacturing facility: AXM reported revenue of \$10.025 million for 2003, and reported revenue for 2004 of \$2.115 million. For the quarter ended September 30, 2004, AXM reported revenue of \$0.

9. In January 2004, AXM obtained a license to sell certain Sunkist-branded vitamins and vitamin supplements in the PRC, Hong Kong, Singapore, Taiwan, and Thailand. According to AXM's Form 10-K for the year ended December 31, 2004, in order to support AXM's Sunkist license agreement, "AXM entered into distribution agreements with Zuellig Xinxing Pharmaceutical Company Limited" ("Zuellig"), described as an

“international pharmaceutical distribution company with offices in the PRC, Hong Kong, Taiwan, Singapore, and Thailand.” In early 2005, AXM created an international sales division to handle sales of the Sunkist products that was to be managed from AXM’s corporate headquarters in Nevada. The international sales division had two employees in the United States, and two employees in Asia. The international sales division reported to Howard, then the CEO and acting CFO.

10. Between March and May 2005, AXM executed three distribution agreements to sell Sunkist products with three separate subsidiaries of Zuellig, each of which conducted business in different geographic regions of Asia: (1) Taiwan; (2) Hong Kong; and (3) the PRC. The agreements between AXM and the Zuellig subsidiaries were substantively similar, and provided for payment to AXM after Zuellig sold the goods to its customers, for the transfer of title upon delivery to Zuellig’s warehouse, and for a right of return for expired and other goods. Howard supervised the negotiations between AXM and the Zuellig subsidiaries, participated in some of the discussions with Zuellig, and received copies of each of the agreements.

A. Howard Caused AXM to Fraudulently Recognize Revenue

11. AXM’s Form 10-Q for the first quarter of 2005, filed May 16, 2005, and signed by Howard, reported in Management’s Discussion and Analysis of Results of Operations and Financial Condition (“MD&A”) that AXM had “received our first purchase orders for Sunkist co-branded products for distribution in Hong Kong, Shanghai and Taiwan. These orders are for approximately \$2.9 million and . . . should be delivered to our distributor in late May.” In the first quarter 2005 Form 10-Q, AXM reported revenue of \$28,260 for the quarter of 2005, compared to revenue of \$1,119,394 for the first quarter of 2004. AXM reported a net loss of \$3.2 million for the first quarter of 2005.

12. Pursuant to the distribution agreements, from March through June 2005, AXM received several purchase orders for Sunkist products from the Zuellig subsidiaries, which totaled approximately \$2.8 million. However, AXM failed to deliver approximately \$1.9 million of the goods ordered before the end of the second quarter, and payment for any of the \$2.8 million of goods was not reasonably assured because they had not been resold. Nonetheless, AXM recognized the entire \$2.8 million of purchase orders as revenue for the quarter ended June 30, 2005.

13. GAAP Statement of Financial Accounting Standards No. 48 (“SFAS No. 48”) provides that where a seller grants a right of return, the seller may not recognize revenue unless, among other conditions, “[1] The buyer has paid the seller, or the buyer is obligated to pay the seller and the obligation is not contingent on resale of the product and [2] The amount of future returns can be reasonably estimated.” Accordingly, GAAP precluded AXM from recognizing or reporting any of the \$2.8 million in orders for Sunkist product as revenue for the second quarter of 2005 because the distribution agreements provided that Zuellig subsidiaries were not obligated to pay AXM until the Sunkist products were resold by Zuellig. Moreover, AXM could not reasonably estimate the amount of returns because AXM and Zuellig did not have a history of selling Sunkist products and AXM did not have a history of receiving payments from Zuellig. Despite this lack of history, Howard unreasonably estimated that AXM would have zero product returned by Zuellig.

14. Additional GAAP provisions precluded recognition of approximately \$1.9 million of the \$2.8 million of fraudulently recognized revenue. GAAP Statement of Accounting Concepts No. 5 (“Concept No. 5”), ¶ 83, provides that revenue should not be recognized until such time as the revenue is (1) realized or realizable, and (2) earned. GAAP provides that these conditions “are usually met by the time produce or merchandise is delivered . . . to customers.” Concept No. 5, ¶ 84(a). The Zuellig subsidiaries had ordered

two main categories of products from AXM: (1) gummy bear vitamin supplements, and (2) soluble vitamin strips. AXM did not deliver any of the soluble vitamin strips to Zuellig before the end of the second quarter. In addition, AXM shipped gummy bear vitamin supplements to Zuellig's Hong Kong subsidiary, even though they had been ordered for delivery to Zuellig's Shanghai subsidiary, because AXM did not have an import license to ship the goods to the PRC or mainland China. Thus, AXM could not properly recognize and report approximately \$1.9 million of the purchase orders as revenue for the second quarter of 2005 because the goods had not been delivered.

15. At the end of the second quarter 2005, Howard knew, or was reckless in not knowing, that only a portion of the gummy bear products had been delivered, and only a partial shipment of soluble strips had been delivered after the end of the second quarter. Howard also knew, or was reckless in not knowing, that under GAAP, AXM could not recognize any of the \$2.8 million in purchase orders as revenue because the Zuellig companies did not have to pay for any goods until they were re-sold to Zuellig's customers, Zuellig had a right of return, and AXM could not reasonably estimate the amount of returns. Indeed, in June 2005, Howard knew that because Zuellig was paying AXM only after the products were re-sold and Zuellig received payment from its customers, then the transactions were "in effect" a "consignment" and it was improper to recognize revenue based on the purchase orders. At all relevant times, Howard acted with scienter.

B. Howard Caused AXM to Issue False Press Releases and File False Reports With the Commission

16. As acting CFO, Howard was responsible for AXM's accounting and public reporting of financial results. As CEO, Howard supervised AXM's international division that was selling the Sunkist products to Zuellig. On or about July 18, 2005, AXM issued a press release which stated, in part:

[AXM] has shipped and booked sales in excess of \$3.1 million in the second quarter and expects to post a quarterly profit. Through the Company's newly formed Asia-Pacific subsidiaries, sales of approximately US\$2.8 million of Sunkist products were achieved in the Hong Kong, Shanghai and Taiwan markets during June 2005.

Howard reviewed and approved the press release before it was issued. AXM attached the press release as an exhibit to a Form 8-K filed on July 21, 2005, which Howard signed.

Howard knew, or was reckless in not knowing, that the press release was materially false and misleading because AXM's reported revenue was fraudulently overstated by \$2.8 million.

17. On August 15, 2005, AXM filed its Form 10-Q for its second quarter of 2005. Howard helped draft, approved, and signed AXM's second quarter Form 10-Q. The financial statements attached to the Form 10-Q reported revenue of \$3.2 million and net income of \$179,000. In the MD&A discussion of AXM's results, AXM stated:

During the three-month period ended June 30, 2005, AXM entered into the Company's first three international markets for its line of Sunkist labeled products. The new markets where products were launched were Hong Kong, Taiwan and Shanghai. This – combined with the ramp up of AXM's new factory in Shenyang, China – enabled the Company to record the best sales quarter in its history.

Howard knew, or was reckless in not knowing, that the financial statements and representations contained in the report of operations in AXM's Form 10-Q were materially false and misleading because he had caused AXM's revenue to be fraudulently inflated.

18. AXM's Form 10-Q for the quarter ended June 30, 2005 included a certification signed by Howard, as AXM's CEO and acting CFO, falsely stating, among other things, that, to the best of his knowledge,

this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report.

Howard further falsely certified that to the best of his knowledge, "the financial statements,

and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.”

19. On August 15, 2005, the same day that AXM filed its Form 10-Q for the second quarter, AXM touted the record-setting quarter in a press release approved by Howard, and during a conference call conducted by Howard. During the conference call, Howard highlighted the “record revenue of approximately \$3.2 million and ... the net profit of approximately \$179,409.” A copy of the press release and a transcript of the conference call were filed with the Commission as attachments to Forms 8-K, each signed by Howard.

20. On October 31, 2005, AXM announced that it would restate its second quarter results because its Audit Committee had determined that “during the second quarter of 2005 the company improperly recognized approximately \$2.8 million of sales revenue and improperly recorded \$1.4 million of related expense.” The press release further stated that “AXM’s financial statements for the second quarter should no longer be relied upon and that a restatement will be required for the quarter.” AXM’s stock price, which was already declining, dropped 10% on the day of this announcement. AXM subsequently restated its second quarter results and reported revenue of \$329,000 and a net loss of approximately \$1.5 million.

C. Howard Violated the Books and Records and Internal Control Requirements of the Federal Securities Laws

21. As a public company, AXM was required to comply with federal statutes, rules, and regulations to maintain public trading of its stock and to sell its securities to the public. These statutes, rules, and regulations required AXM to, among other things, (a) make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect its transactions and dispositions of assets; (b) devise and maintain a system of internal

accounting controls sufficient to provide reasonable assurances that the transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP, or any other criteria applicable to such statements and to maintain accountability for assets; and (c) file with the Commission accurate quarterly reports on the appropriate Commission forms, which include financial statements containing the company's balance sheet and statements of income and cash flows prepared in conformity with GAAP.

22. AXM's books and records did not accurately and fairly reflect its transactions for the second quarter of 2005 because improper recording of \$2.8 million of revenue materially overstated its reported revenue.

23. As acting CFO, Howard was responsible for AXM's accounting policies. AXM's revenue recognition policy, disclosed in its Form 10-K for the year ended December 31, 2004, stated:

AXM Pharma recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectibility is probable.

Product sales are recognized by AXM Pharma generally at the time the product is shipped. Shipping and handling costs are incurred in costs of goods sold.

24. In its second quarter Form 10-Q, drafted and signed by Howard, AXM changed the disclosure of its revenue recognition policy, without stating that there had been a change or disclosing reasons for a change:

Product sales revenue is recognized upon passage of title to customers, typically upon shipment of product. Any provision for discounts and estimated returns are accounted for in the period the related sales are recorded.

AXM's revenue recognition policy disclosed in the second quarter 2005 Form 10-Q failed to comply with various provisions of GAAP. At least for the second quarter of 2005, AXM did not have any internal controls to insure that revenue was recorded in conformity with GAAP.

D. Howard Made False Statements to AXM's Independent Accountant

25. AXM's financial statements, included in its second quarter Form 10-Q, were reviewed by an independent public accountant. In connection with that review, including in a management representation letter to the accountant dated August 15, 2005, Howard falsely represented that AXM's financial statements had been prepared in accordance with GAAP. Howard knew that his representation was false. Howard also failed to disclose to AXM's accountant that approximately \$1.9 million of the Sunkist goods had not been delivered before the end of the second quarter.

FIRST CLAIM FOR RELIEF

Fraud in Connection With the Purchase or Sale of Securities

(Violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder)

26. The Commission realleges and incorporates by reference paragraphs 1 through 25 above.

27. Defendant Howard, by engaging in the conduct described above, directly or indirectly, in connection with the purchase or sale of a security, by the use of means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange, with scienter;

- a. employed devices, schemes, or artifices to defraud;
- b. made untrue statements of a material fact or omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or
- c. engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon other persons.

28. By engaging in the conduct described above, defendant Howard violated Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R.

§ 240.10b-5.

SECOND CLAIM FOR RELIEF

Record-Keeping Violations

(Violations and Aiding and Abetting Violations of Section 13(b)(2)(A) of the Exchange Act and Rule 13b2-1 Thereunder)

29. The Commission realleges and incorporates by reference paragraphs 1 through 25 above.

30. Defendant Howard, directly or indirectly, falsified or caused to be falsified, books, records, or accounts required by Section 13(b)(2)(A) of the Exchange Act, 15 U.S.C. § 78m(b)(2)(A), and AXM violated that provision by failing to make or keep books, records, and accounts, which, in reasonable detail accurately and fairly reflected its transactions and dispositions of assets. As detailed above, defendant Howard knowingly or recklessly provided substantial assistance to AXM in its violation of Section 13(b)(2)(A) of the Exchange Act.

31. By reason of the foregoing, defendant Howard violated Exchange Act Rule 13b2-1, 17 C.F.R. § 240.13b2.1, and also aided and abetted AXM's violations of Section 13(b)(2)(A) of the Exchange Act, 15 U.S.C. § 78m(b)(2)(A).

THIRD CLAIM FOR RELIEF

Certification Violations

(Violations of Rule 13a-14 under the Exchange Act)

32. The Commission realleges and incorporates by reference paragraphs 1 through 25 above.

33. Defendant Howard, in his role as principal executive and principal financial officer, signed a certification included in AXM's quarterly report on Form 10-Q for the quarter ended June 30, 2005, that falsely stated that the quarterly report did not contain any

untrue statement of material fact or material omissions, and that falsely stated that the financial statements, and other financial information included in the quarterly report, fairly presented in all material respects the financial condition, results of operations and cash flows of AXM.

34. By engaging in the conduct described above, defendant Howard violated Rule 13a-14 under the Exchange Act, 17 C.F.R. §240.13a-14.

FOURTH CLAIM FOR RELIEF

False Statement to Accountant

(Rule 13b2-2 under the Exchange Act)

35. The Commission realleges and incorporates by reference paragraphs 1 through 25 above.

36. Defendant Howard, by engaging in the conduct described above, directly or indirectly (a) made or caused to be made materially false or misleading statements to accountants in connection with; or (b) omitted to state, or caused another person to omit to state, material facts necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading, to accountants in connection with (i) an audit, review or examination of the financial statements of the issuer required to be made; or (ii) the preparation or filing of a document or report required to be filed with the Commission.

37. By engaging in the conduct described above, defendant Howard violated Rule 13b2-2 under the Exchange Act, 17 C.F.R. § 240.13b2-2.

FIFTH CLAIM FOR RELIEF

Periodic and Current Reporting Violations

(Aiding and Abetting Violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 thereunder)

38. The Commission realleges and incorporates by reference paragraphs 1 through 25 above.

39. AXM violated Section 13(a) of the Exchange Act, 15 U.S.C. § 78m(a), and Rules 12b-20, 13a-11, and 13a-13 thereunder, 17 C.F.R. §§ 240.12b-20, 240.13a-11 & 240.13a-13, by filing with the Commission a required periodic report for the quarter ended June 30, 2005, and current reports filed July 21 and August 15, 2005, which contained materially false or misleading information and which failed to include material information necessary to make the required statements, in light of the circumstances under which they were made, not misleading.

40. Defendant Howard knowingly provided substantial assistance to AXM in its violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 thereunder.

41. By engaging in the conduct described above and pursuant to Section 20(e) of the Exchange Act, 15 U.S.C. § 78t(e), defendant Howard aided and abetted AXM's violations of Section 13(a) of the Exchange Act, 15 U.S.C. § 78m(a), and Rules 12b-20, 13a-11, and 13a-13 thereunder, 17 C.F.R. §§ 240.12b-20, 240.13a-11 & 240.13a-13.

SIXTH CLAIM FOR RELIEF

Internal Control Violations

(Aiding and Abetting Violations of Section 13(b)(2)(B) of the Exchange Act)

42. The Commission realleges and incorporates by reference paragraphs 1 through 25 above.

43. AXM violated Section 13(b)(2)(B) of the Exchange Act, 15 U.S.C. §78m(b)(2)(B), by failing to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that: (a) transactions were executed in accordance with management's general or specific authorization; (b) transactions were

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

44. Defendant Howard knowingly provided substantial assistance to AXM in its violations of Section 13(b)(2)(B) of the Exchange Act.

45. By engaging in the conduct described above and pursuant to Section 20(e) of the Exchange Act, 15 U.S.C. § 78t(e), defendant Howard aided and abetted AXM's violations of Section 13(b)(2)(B) of the Exchange Act, 15 U.S.C. § 78m(b)(2)(B).

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that the Court:

I.

Issue findings of fact and conclusions of law that the defendant committed the alleged violations.

II.

Issue a judgment, in a form consistent with Fed. R. Civ. P. 65(d), permanently enjoining defendant Howard and his agents, servants, employees, and attorneys, and those persons in active concert or participation with him, who receive actual notice of the judgment by personal service or otherwise, and each of them, from violating Section 10(b) of the Exchange Act, 15 U.S.C. §§ 78j(b), and Rules 10b-5, 13a-14, 13b2-1 and 13b2-2 thereunder, 17 C.F.R. §§ 240.10b-5, 240.13a-14, 240.13b2-1 & 240.13b2-2, and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, 15 U.S.C. §§ 78m(a), 78m(b)(2)(A)& 78m(b)(2)(B), and Rules 12b-20, 13a-11 and 13a-13 thereunder, 17

C.F.R. §§ 240.12b-20, 240.13a-11 & 240.13a-13.

III.

Enter an order, pursuant to Section 21(d)(2) of the Exchange Act, 15 U.S.C. § 78u(d)(2), barring defendant Howard from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act, 15 U.S.C. § 78l, or that is required to file reports pursuant to Section 15(d) of the Exchange Act, 15 U.S.C. §78o(d).

IV.

Order defendant to pay civil penalties pursuant to Section 21(d)(3) of the Exchange Act, 15 U.S.C. § 78u(d)(3).

V.

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered, or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

VI.

Grant such other and further relief as this Court may determine to be just and necessary.

DATED: February 21, 2008

Respectfully submitted,

/s/

JOHN B. BULGOZDY
SOLOMON MANGOLINI

Attorneys for Plaintiff
U. S. Securities and Exchange Commission