

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :
 :
DIATECT INTERNATIONAL : INITIAL DECISION
CORPORATION : January 30, 2008
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APPEARANCES: Karen L. Martinez and Thomas M. Melton for the Division of Enforcement, Securities and Exchange Commission.

Wallace T. Boyack for Respondent Diatect International Corporation.

BEFORE: James T. Kelly, Administrative Law Judge.

The Securities and Exchange Commission (SEC or Commission) issued its Order Instituting Proceedings (OIP) on September 27, 2007, pursuant to Section 12(j) of the Securities Exchange Act of 1934 (Exchange Act). The OIP alleges that Diatect International Corporation (Diatect or Respondent), an issuer of publicly traded securities, failed to file annual and quarterly reports with the Commission for any period after the quarter ended March 31, 2005.

The OIP charges that, through this conduct, Diatect has failed to comply with Section 13(a) of the Exchange Act and Exchange Act Rules 13a-1 and 13a-13. The Commission instituted this proceeding to determine whether these allegations are true, to afford Diatect an opportunity to establish any defenses to such allegations, and to decide whether the registration of Diatect's securities should be suspended or revoked for the protection of investors.

Diatect received the OIP on October 9, 2007. The Commission's Division of Enforcement (Division) notified Diatect of the opportunity to inspect and copy its investigative file on October 16, 2007. Diatect filed an Answer to the OIP on October 29, 2007.

At a telephonic prehearing conference, I granted the parties leave to file cross-motions for summary disposition (Order of Oct. 31, 2007). The Division filed its motion for summary disposition, with accompanying exhibits and a sworn declaration, on November 5, 2007. Diatect submitted its opposition to the Division's motion and a cross-motion for summary disposition on

December 4, 2007. The Division filed a reply in support of its motion and an opposition to Diatect's cross-motion on December 17, 2007. Diatect filed a reply in support of its cross-motion on January 2, 2008.

The Standards for Summary Disposition

Rule 250(a) of the Commission's Rules of Practice provides that, after a respondent's answer has been filed and documents have been made available to that respondent for inspection and copying, a party may make a motion for summary disposition of any or all allegations of the OIP with respect to that respondent. The facts of the pleadings of the party against whom the motion is made shall be taken as true, except as modified by stipulations or admissions made by that party, by uncontested affidavits, or by facts officially noted pursuant to Rule 323 of the Commission's Rules of Practice.

Rule 250(b) of the Commission's Rules of Practice requires the hearing officer promptly to grant or deny the motion, or to defer decision on the motion. The hearing officer may grant the motion for summary disposition if there is no genuine issue with regard to any material fact and the party making the motion is entitled to a summary disposition as a matter of law.

In assessing the summary disposition record, the facts, as well as the reasonable inferences that may be drawn from them, must be viewed in the light most favorable to the non-moving party. See Felix v. N.Y. City Transit Auth., 324 F.3d 102, 104 (2d Cir. 2003); O'Shea v. Yellow Tech. Svcs., Inc., 185 F.3d 1093, 1096 (10th Cir. 1999); Cooperman v. Individual, Inc., 171 F.3d 43, 46 (1st Cir. 1999).

By analogy to Rule 56 of the Federal Rules of Civil Procedure, a factual dispute between the parties will not defeat a motion for summary disposition unless it is both genuine and material. See Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247-48 (1986). Once the moving party has carried its burden, "its opponent must do more than simply show that there is some metaphysical doubt as to the material facts." Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 586 (1986). The opposing party must set forth specific facts showing a genuine issue for a hearing and may not rest upon the mere allegations or denials of its pleadings. At the summary disposition stage, the hearing officer's function is not to weigh the evidence and determine the truth of the matter, but rather to determine whether there is a genuine issue for resolution at a hearing. See Anderson, 477 U.S. at 249.

FINDINGS OF FACT

Diatect is a California corporation, headquartered in Heber City, Utah. It produces and markets insecticides made from diatomaceous earth. Diatect's common stock has been registered with the Commission under Section 12(g) of the Exchange Act since 1993. Until October 21, 2005, Diatect's common stock was quoted on the OTC Bulletin Board. Thereafter, its stock has been quoted in the Pink Sheets, disseminated by Pink Sheets LLC.

Williams & Webster, P.S. (W&W), of Spokane, Washington, served as Diatect's independent auditor until November 2004 (Form 8-K, filed Nov. 5, 2004). Diatect engaged Hansen Barnett & Maxwell, P.C. (HB&M), of Salt Lake City, Utah, as its independent auditor in February 2005 (Form 8-K, filed Mar. 1, 2005). W&W audited Diatect's 2003 financial statements (Form 10-KSB, filed Apr. 14, 2004; First Amended Form 10-KSB/A, filed Apr. 29, 2004; Second Amended Form 10-KSB/A, filed May 17, 2004). Diatect restated and HB&M re-audited the issuer's 2003 financial statements in May 2005 (Form 10-KSB/A, filed May 6, 2005). HB&M has continued to serve as Diatect's independent auditor from February 2005 until the present (Prehearing Conference of Oct. 31, 2007, at 10-11).

On June 9, 2005, three creditors filed an involuntary bankruptcy petition against Diatect in the U.S. Bankruptcy Court for the District of Utah. In April 2006, Diatect and its creditors entered into a settlement agreement. On June 1, 2006, the Bankruptcy Court dismissed the proceeding with prejudice.

On June 12, 2007, the Public Company Accounting Oversight Board (PCAOB or Board) found that W&W and its principals had violated PCAOB auditing standards when auditing Diatect's 2003 financial statements (Diatect Opposition, filed Dec. 4, 2007, Exhibit 3). The Board issued a consent order that censured W&W, barred one of the firm's principals, and suspended the firm's other principal.¹

On September 24, 2007, the Commission filed a civil action against Diatect and three of its current or former officers and directors in the U.S. District Court for the District of Utah. SEC v. Diatect Int'l Corp., No. 2:07-cv-0709 (D. Utah). The Commission's complaint alleges violations of the antifraud and reporting provisions of the federal securities laws and pertains to reports that Diatect filed with the Commission in 2003 and 2004.² As relief, the Commission's complaint seeks permanent injunctions, officer and director bars, disgorgement of ill-gotten gains, and civil monetary penalties. The defendants have filed answers, and the matter remains pending.

When the Commission issued the OIP on September 27, 2007, Diatect was delinquent in filing two annual reports and seven quarterly reports. Between October 24, 2007, and January 2,

¹ W&W and its principals settled without admitting or denying the PCAOB's findings. The findings in the Board's consent order are not binding on the Commission, the Division, or Diatect in this administrative proceeding.

² The Division urges me to make factual findings about several events that occurred in 2003 and 2004. For example, the Division asserts that Diatect filed false financial information in 2003 with respect to the sale of certain Bureau of Land Management claims. It also alleges that Diatect filed two quarterly reports during 2004 without the required review by an independent auditor. These are precisely the issues before the federal district court in the Commission's civil injunctive action (Div. Motion, filed Nov. 5, 2007, Exhibit E, ¶¶ 3, 5, 21-67, 75-80). Diatect is contesting these issues in the civil action (Div. Reply, filed Dec. 17, 2007, Exhibit C). These are material issues as to which there are genuine disputes, and summary disposition cannot be granted to the Division on that basis. The Division's request is therefore denied.

2008, Diatect filed all of its overdue periodic reports with the Commission. Diatect is now current in its periodic reporting requirements.

DISCUSSION AND CONCLUSIONS

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 that the issuer of such security has failed to comply with any provision of the Exchange Act or the rules and regulations thereunder. The Division seeks revocation in this proceeding.

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.

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):

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.”

I conclude that Diatect’s undisputed failure to file timely periodic reports from July 2005 through December 2007 violated Section 13(a) of the Exchange Act and Exchange Act Rules 13a-1 and 13a-13. Diatect filed its overdue periodic reports between October 24, 2007, and January 2, 2008, and is now current in its periodic reporting obligations. However, that fact does not extinguish the violation. See Phlo Corp., 90 SEC Docket 1089, 1108 (Mar. 30, 2007) (“the fact that Phlo eventually cleared up its backlog of overdue filings does not cure its earlier violations”).

The Public Interest

In Gateway Int’l Holdings, Inc., 88 SEC Docket 430, 439 (May 31, 2006), the Commission stated that, in determining the appropriate sanction in a Section 12(j) proceeding, it “will consider, among other things, the seriousness of the issuer’s violations, the isolated or

recurrent nature of the violations, the degree of culpability involved, the extent of the issuer's efforts to remedy its past violations and ensure future compliance, and the credibility of its assurances, if any, against further violations."

Diatect's failure to file timely periodic reports is a serious violation of "a central provision of the Exchange Act." Gateway, 88 SEC Docket at 441. Diatect's violations were repeated and ongoing from July 2005 through December 2007. Diatect's claim that it lacked resources and was defending against an involuntary bankruptcy petition until June 2006 does not mitigate the violations. Nor can Diatect evade responsibility for the violations by arguing that it was not well served by W&W, its auditor until November 2004. Diatect's conduct evidenced a high degree of culpability: the issuer knew of its reporting obligations, yet failed to file nine periodic reports over more than two years.

In e-Smart Technologies, Inc., 83 SEC Docket 3586, 3592 (Oct. 12, 2004) (Order Remanding Proceeding), the Commission stated that an issuer's filing history subsequent to the OIP is an important factor to be considered in determining whether revocation is necessary or appropriate for the protection of investors. Diatect has recently devoted significant resources to satisfying its reporting obligations. In its Answer and at the prehearing conference, Diatect provided a schedule for becoming current. Over the past few months, it has kept its commitments. Diatect is entitled to credit for becoming current, even if it did not begin to take its filing obligations seriously until after the Commission issued the OIP. The investing public now has access to past and current audited financial information.

David H. Andrus (Andrus), Diatect's acting president, has submitted two sworn declarations in this proceeding. Andrus's Declaration of December 3, 2007, ¶¶ 10, 16, acknowledges the obvious: Diatect has the responsibility to file timely complete and accurate periodic reports. Andrus offers conclusions, but no specifics, about Diatect's ability to comply with the periodic reporting requirements in the future. See Andrus Declaration of December 3, 2007, ¶ 7 (Diatect is "serious" about timely filing future periodic reports); ¶ 16 (Diatect's financial reporting procedures "seem" to be improved and working well); Andrus Declaration of January 2, 2008, ¶ 9 (the fact that Diatect is now current "indicates" that Diatect has the personnel to prepare its financial statements in a timely manner; Diatect's procedures "seem" to be improved and working well). Andrus does not identify the number of financial personnel Diatect has hired, or state whether they are full-time or part-time. This is a troubling omission, in view of the disarray that marked Diatect's financial staffing in 2006 and 2007 (Prehearing Conference of Oct. 31, 2007, at 12-14).

The Division maintains that revocation is the appropriate remedy for Diatect's violations, even though the Respondent has belatedly complied with its periodic reporting obligations. In essence, the Division asks me to determine that the allegations in the Commission's injunctive action—as yet, unproven—are aggravating factors. I decline to do so. See supra n.2. Any proven antifraud violations can be addressed by permanent injunctions and officer and director bars in the pending civil action. Expelling Diatect from the ranks of public companies as a result of this administrative proceeding would be punitive.

In light of these considerations, the sanctions of revocation or suspension will not be imposed and the proceeding will be dismissed. Cf. Phlo Corp., 90 SEC Docket at 1115-16.

ORDER

Based on the findings and conclusions set forth above, the Division of Enforcement's motion for summary disposition is denied and Diatect International Corporation's cross-motion for summary disposition is granted. I conclude that Diatect violated Section 13(a) of the Securities Exchange Act of 1934 and Exchange Act Rules 13a-1 and 13a-13. I further conclude that neither of the two permissible sanctions, revocation or suspension for twelve months or less, is necessary or appropriate for the protection of investors.

IT IS ORDERED THAT the Division of Enforcement's request to revoke or suspend the registration of all classes of registered securities of Diatect International Corporation is denied and the proceeding is dismissed.

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 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.

This 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 the Initial Decision as to any party. If any of these events occur, the Initial Decision shall not become final as to that party.

James T. Kelly
Administrative Law Judge