

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Administrative Proceedings Rulings  
Release No. 6421 / December 20, 2018

Administrative Proceeding  
File No. 3-17950

In the Matter of  
**David Pruitt, CPA**

**Order Granting in Part Motion  
for More Definite Statement**

The motion of Respondent David Pruitt, CPA, for a more definite statement is granted in part.

*Background*

The Securities and Exchange Commission issued the order instituting this proceeding (OIP) in April 2017. A lot has happened since then. Through 2017 and early 2018, the case progressed through motions practice, a stay, the Commission's ratification of the appointment of its administrative law judges, my later ratification of previous actions, and more motions practice.<sup>1</sup> And then the Supreme Court decided *Lucia v. SEC*.<sup>2</sup> As a result of *Lucia* and with the parties' agreement, this proceeding returned to where it started. Pruitt now moves for a more definite statement.

According to the OIP, this case involves allegations that L3 Technologies, Inc., improperly recognized \$17.9 million in revenue at its Army Sustainment Division (ASD) subsidiary.<sup>3</sup> Pruitt, who was allegedly the Vice President of

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<sup>1</sup> See *Pending Admin. Proc.*, Securities Act of 1933 Release No. 10440, 2017 WL 5969234 (Nov. 30, 2017); *David Pruitt, CPA*, Admin. Proc. Ruling Release No. 5599, 2018 SEC LEXIS 470 (ALJ Feb. 14, 2018); *David Pruitt, CPA*, Admin. Proc. Ruling Release No. 5229, 2017 SEC LEXIS 3596 (ALJ Nov. 15, 2017).

<sup>2</sup> 138 S. Ct. 2044 (2018).

<sup>3</sup> OIP ¶¶ II.A.1, II.A.2.

Finance at ASD, is claimed to have instructed a subordinate to create invoices in L3’s internal accounting system related to unresolved claims and withhold delivery of those invoices from a customer.<sup>4</sup> The OIP alleges that the failure to deliver the invoices to the customer represented a “violation of a specific internal control of L3 that required delivery of invoices.”<sup>5</sup> As a result of his actions, Pruitt is alleged to have willfully violated Exchange Act Section 13(b)(5), caused L3’s violation of Exchange Act Section 13(b)(2)(A), and violated Exchange Act Rule 13b2–1.<sup>6</sup>

In his motion, Pruitt first argues that new evidence “irrefutably establish[es]” that the “key” allegations in the OIP have no basis in fact.<sup>7</sup> He also argues that the OIP should identify “the specific books and records that he allegedly caused to be inaccurate, including the legal basis for how these books and records were not kept in the ‘reasonable detail’ required by statute, and the internal control that he allegedly circumvented.”<sup>8</sup> According to Pruitt, the “reference to a ‘specific internal control of L3’ without identifying the internal control is precisely the type of ‘vague, ambiguous and generalized’ allegation that does not suffice.”<sup>9</sup> And the OIP’s reference to inaccurate books and records is overly nonspecific.<sup>10</sup> Finally, Pruitt asserts that because the sanctions sought are severe, more specificity is required.<sup>11</sup>

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<sup>4</sup> OIP ¶ I.A.2.

<sup>5</sup> OIP ¶ II.K.39.

<sup>6</sup> OIP ¶¶ II.M.43, II.M.44, II.M.45. Section 13(b)(2)(A) requires issuers to “make and keep books, records, and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.” 15 U.S.C. § 78m(b)(2)(A). Section 13(b)(5) prohibits “knowingly circumvent[ing] or knowingly fail[ing] to implement a system of internal accounting controls or knowingly falsify[ing] any book, record, or account described in” Section 13(b)(2). 15 U.S.C. § 78m(b)(5). Rule 13b2–1 states that “No person shall, directly or indirectly, falsify or cause to be falsified, any book, record or account subject to section 13(b)(2)(A).” 17 C.F.R. § 240.13b2–1.

<sup>7</sup> Mem. at 5–6.

<sup>8</sup> *Id.* at 7.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at 8–9.

The Division counters that as supplemented by a letter the Division submitted in June 2017, the OIP is sufficient under the Commission’s Rules of Practice.<sup>12</sup> It says that because Pruitt has long had access to its investigative file and has conducted discovery, he “knows what this case is about” and is actually trying to obtain a list of the Division’s evidence and its theory of the case, things he is not entitled to receive.<sup>13</sup>

As to the books-and-records allegation, the Division notes that “books, records[,] and accounts’ is a very broad phrase and has been construed to include ‘virtually any tangible embodiment of information made or kept by an issuer.’”<sup>14</sup> According to the Division, the OIP identifies the books and records Pruitt “falsified or caused to be falsified, *such as:*” the allegedly “fictitious invoices,” certain e-mails, and journal entries recognizing revenue.<sup>15</sup> The Division also refers to seventeen categories of books, records, or accounts it identified in its June 2017 letter.<sup>16</sup> These include unsubmitted invoices, certain quarterly and annual reports, post-closing journal entries, L3’s general and other ledgers, accounts receivable reports, trial balance and balance sheet, consolidation schedules, schedules 14C, correspondence, accounting policies and procedures, internal controls documentation, and auditor’s work papers.<sup>17</sup>

The Division also disputes that the phrase *a specific internal control* in the OIP limits the Division to “only one” internal control.<sup>18</sup> It says the OIP recites that violations of Section 13(b)(5), the provision relevant to this factual allegation, can include circumvention of “a system of internal

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<sup>12</sup> Opp’n at 4–5. In June 2017, I granted in part Pruitt’s previous motion for a more definite statement and directed the Division to submit a list of the internal control or controls that it asserted Pruitt violated. *David Pruitt, CPA*, Admin. Proc. Rulings Release No. 4888, 2017 SEC LEXIS 1945 (June 23, 2017). The Division responded with a letter listing sixteen internal controls. *See Letter from Paul G. Gizzi* (June 30, 2017).

<sup>13</sup> Opp’n at 5–6.

<sup>14</sup> *Id.* at 8 (quoting *SEC v. World-Wide Coin Invs., Ltd.*, 567 F. Supp. 724, 749 (N.D. Ga. 1983)).

<sup>15</sup> *Id.* at 9 (emphasis added).

<sup>16</sup> *Id.* at 10.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* at 11.

accounting controls.”<sup>19</sup> Plus, the Division identified sixteen internal controls in its June 2017 letter and provided Pruitt with its original expert report, which provided detail about “L3’s internal controls environment.”<sup>20</sup>

In footnotes, the Division disputes Pruitt’s view of the evidence and the strength of the Division’s case.<sup>21</sup> It also disagrees that the severity of possible sanctions is a basis for more specificity.<sup>22</sup>

In reply, Pruitt says that he is only asking for the Division to identify “the actual books and records that are allegedly inaccurate, the specific internal control that was allegedly circumvented, and the specific acts or omissions, in light of the new evidence put forth by Respondent, that the Division now believes support the purported violations of the Exchange Act.”<sup>23</sup> Pruitt also faults the Division for relying on filings that predate *Lucia*, which he asserts are not “part of the operative record,” and filings it has submitted to the Commission in response to a motion Pruitt filed.<sup>24</sup>

#### *Discussion*

Commission administrative proceedings begin when it issues an OIP.<sup>25</sup> If the OIP does not require an answer, the OIP need only “[c]ontain a short and plain statement of the matters of fact and law to be considered and determined.”<sup>26</sup> But if the OIP requires an answer, the OIP must “set forth the factual and legal basis alleged therefor in such detail as will permit a specific response thereto.”<sup>27</sup> Although, so far as can be determined, the Commission has not delved into the specific requirements for each type of OIP, the rules

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<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 12.

<sup>21</sup> *Id.* at 7–8 nn.5, 6.

<sup>22</sup> *Id.* at 12.

<sup>23</sup> Reply at 2.

<sup>24</sup> *Id.* at 4–5.

<sup>25</sup> See 17 C.F.R. § 201.200(a)(1).

<sup>26</sup> 17 C.F.R. § 201.200(b)(3).

<sup>27</sup> *Id.*

make it clear that an OIP requiring an answer needs more detail than one that does not require an answer.<sup>28</sup>

A respondent may move under Rule of Practice 220(d) for a more definite statement by “stat[ing] the respects in which, and the reasons why, each ... matter of fact or law [to be considered or determined] should be required to be made more definite.”<sup>29</sup> Commission precedent dictates that a respondent is entitled in an OIP to notice of the charges against him but not disclosure of evidence.<sup>30</sup> Because the Commission’s policy, however, is “to encourage ... the exchange of relevant information where practical and reasonable to expedite proceedings, arrive at settlements or simplification of the issues and assure fairness to respondents,”<sup>31</sup> administrative law judges retain the discretion to order the Division to provide greater specificity even if a respondent fails to show that a more definite statement is required.<sup>32</sup>

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<sup>28</sup> This means that cases interpreting the requirements of Federal Rule of Civil Procedure 8(a)(2), which also contains the phrase *short and plain statement*, are of limited usefulness in trying to determine the minimum requirements of an OIP that requires an answer. The differences between Commission administrative proceedings and district court litigation also explain why motions for more definite statement *may* find more favor before the Commission than in district courts. *See Pruitt*, 2017 SEC LEXIS 1945, at \*6 n.1.

<sup>29</sup> 17 C.F.R. § 201.220(d).

<sup>30</sup> *See Murray Sec. Corp.*, Exchange Act Release No. 5510, 1957 WL 52415, at \*1 (May 2, 1957); *see also Michael J. Meehan*, No. 4-232, 1935 WL 29831, at \*2 (Dec. 6, 1935) (holding that neither the Due Process Clause nor the Exchange Act “require that all the particular acts, which together constitute the offense, shall be detailed and itemized. Such particulars are ‘matters of evidence and not of averment.’”) (quoting *United States v. Gooding*, 25 U.S. (12 Wheat.) 460, 474 (1827)).

<sup>31</sup> Miscellaneous Amendments, 37 Fed. Reg. 23,827, 23,827 (Nov. 9, 1972).

<sup>32</sup> *Murray Sec.*, 1957 WL 52415, at \*2; *see* 37 Fed. Reg. at 23,827 (noting with approval “the trend ... in orders issued by hearing officers toward requiring the disclosure of more information in advance of hearing” and conferring authority “in the exercise of ... sound discretion” to direct disclosure “even of ... evidentiary” materials).

At the outset, I do not rely on the Division's June 2017 letter, which is not among the matters on which the parties agreed to rely in going forward with this proceeding after *Lucia*.<sup>33</sup>

The claim that Pruitt violated Section 13(b)(5), which prohibits knowingly circumventing a system of internal controls, includes the factual allegation that the failure to deliver invoices represented a "violation of a specific internal control of" L3. Despite the suggestion in the OIP that Pruitt violated one specific internal control, the Division says he violated up to sixteen internal controls. Contrary to the Division's argument, Pruitt merely wants to know what violations allegedly occurred, not the evidence the Division will use to prove he committed the violations. The controls at issue are not evidence of Pruitt's violation, and the allegation that Pruitt violated Section 13(b)(5) has little meaning without knowing which controls Pruitt allegedly violated. In addition, disclosure will expedite disposition of this case. Within 14 days, the Division shall file a letter listing the "specific internal control of L3" it alleges that Pruitt violated.<sup>34</sup>

As to Pruitt's argument about the books-and-records allegation, it is apparent that Pruitt is not asking for the evidence on which the Division will rely but is instead asking for the Division to state the basis for the allegation. The issue is not how the Division will prove that Pruitt falsified or caused to be falsified certain books, records, and accounts but rather what books, records, and accounts are at issue. In light of the Division's argument that the phrase *books, records, and accounts* is "very broad" and "include[s] 'virtually any tangible embodiment of information made or kept by an issuer,'"<sup>35</sup> it is reasonable to require additional specificity, particularly because greater specificity will expedite disposition of this case.<sup>36</sup> The Division's opposition purports to provide specificity but because it uses the phrases *such as* and *for instance* to preface its description of the books, records, and accounts at issue, it is unclear whether the Division's description

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<sup>33</sup> See Letter from Paul G. Gizzi and Jimmy Fokas (Oct. 2, 2018).

<sup>34</sup> See *Murray Sec.*, 1957 WL 52415, at \*1–2 (exercising discretion to order disclosure of certain information after holding that a respondent is entitled to be "sufficiently informed of the nature of the charges against him so that he may adequately prepare his defense," but "is not entitled to a disclosure of evidence"); 37 Fed. Reg. at 23,827.

<sup>35</sup> Opp'n at 8.

<sup>36</sup> See *Murray Sec.*, 1957 WL 52415, at \*2; 37 Fed. Reg. at 23,827.

is exhaustive.<sup>37</sup> In the letter listing the internal control Pruitt allegedly violated, the Division shall provide an explanation of the categories of documents that it alleges are implicated by the phrase *books, records, and accounts* that Pruitt allegedly falsified or caused to be falsified. If the description of books, records, and accounts found on pages 9 and 10 of the Division's opposition is exhaustive, the Division should so state. If there are additional categories, the Division shall describe them with enough specificity that documents falling within the categories can be identified.

Finally, I reject Pruitt's argument that because, in his view, new evidence "irrefutably establish[es]" that "key" allegations in the OIP have "no factual basis," he is entitled to relief.<sup>38</sup> His view of the strength or weakness of the Division's case is not a basis for a more definite statement.

I encourage the parties to work together to resolve any further disputes regarding the matters addressed in this order. If, however, Pruitt objects to the adequacy of the Division's disclosure, he may do so by letter brief filed within five business days after service of the Division's disclosure. The Division may respond within five business days. No replies should be filed unless directed. The parties are advised that vague assertions of general principles will not be helpful in resolving any dispute regarding this issue. They should instead focus their efforts on discussing precedent from any venue dealing with similar factual circumstances.

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James E. Grimes  
Administrative Law Judge

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<sup>37</sup> Opp'n at 9–10.

<sup>38</sup> Mem. at 5–6.