

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

Administrative Proceedings Rulings
Release No. 4888/ June 23, 2017

Administrative Proceeding
File No. 3-17950

In the Matter of
David Pruitt, CPA

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

Respondent David Pruitt, CPA, moves for a more definite statement. The Division of Enforcement opposes Pruitt's motion. As is discussed below, Pruitt's motion is granted in part.

Background

In the order instituting proceedings (OIP), the Division alleges that Pruitt caused violations of Section 13(b)(2)(A) of the Securities Exchange Act of 1934, which requires issuers to maintain accurate books, records, and accounts "reflect[ing] the transactions and dispositions of assets of the issuer." OIP at 11. The Division also alleges that Pruitt willfully violated Exchange Act Section 13(b)(5), which prohibits knowingly circumventing or failing to implement internal accounting controls or knowingly falsifying an issuer's books, records, or accounts. *Id.* Finally, the Division contends that Pruitt willfully violated Exchange Act Rule 13b2-1, which prohibits falsifying, or causing to be falsified, "any book, record[,] or account subject to" Exchange Act Section 13(b)(2)(A). *Id.*

In his motion, Pruitt requests greater specificity regarding the (1) "specific internal control" the Division believes he circumvented; and (2) the books and records he allegedly falsified or made inaccurate. Mot. at 1.

In opposition to the internal controls aspect of Pruitt’s motion, the Division first asserts that Pruitt is mistaken to say that he is charged “with circumventing only one of [the issuer’s] internal accounting controls.” Opp’n at 3 n.3. Later, however, it notes that the relevant allegation in the OIP is that “invoices had not been delivered to [the issuer’s customer], in violation of *a specific internal control* of [the issuer] that required delivery of invoices.” *Id.* at 6 (emphasis added) (quoting OIP at 10). In the next sentence, the Division asserts “that Pruitt intentionally circumvented the following of [the issuer’s] Internal Controls Over Financial Reporting (*among others*): IR4, IR5, and FR4A.” *Id.* (emphasis added).

Pruitt responds that the Division’s use of the phrase “among others” forces him to guess which controls among seventy-nine pages of almost 500 controls the Division believes he violated. Reply at 6. He believes this is unreasonable because “the Division must know by now what controls it believes were circumvented” and because he would like to employ an expert to address the controls that are issue. *Id.*

In opposition to the books and records aspect of Pruitt’s motion, the Division asserts that the phrase “books, records[,] and accounts” is construed quite broadly to encompass “any tangible embodiment of information made or kept by an issuer.” Opp’n at 4 (quoting *SEC v. World-Wide Coin Inv.*, 567 F. Supp. 724, 748–49 (N.D. Ga. 1983)). The Division says the OIP is full of allegations that inform Pruitt which books and records he falsified or caused to be falsified. *Id.* at 4. It says the allegations include “fictitious invoices,” e-mails to the issuer and its auditor that falsely conveyed the message that the customer could be invoiced on unresolved claims, and “improper entries in [the issuer’s] financial statements.” *Id.* at 4–5. The Division continues, “[s]pecifically” naming a variety of records described in the OIP. *Id.* at 5. Notwithstanding this specificity, the Division concludes that given the issuer’s size—it “realized over \$12 billion in net revenue in 2013”—and the broad definition of “books, records[,] and accounts,” it need not specify every book, record, or account that was falsified. *Id.* at 5–6.

In response, Pruitt questions the Division’s “unbounded” construction of “books, records[,] and accounts,” which he argues provides no limits to what might constitute a book or record. Reply at 4. He asserts that he cannot prepare a defense if nearly every document falls within the ambit of “books, records, and accounts.” *Id.*

Discussion

The Securities and Exchange Commission initiates administrative proceedings by issuing an OIP. *See* 17 C.F.R. § 201.200(a)(1). If no answer to

the OIP is required, the OIP need only “[c]ontain a short and plain statement of the matters of fact and law to be considered and determined.” 17 C.F.R. § 201.200(b)(3). If an answer is required, the OIP must “set forth the factual and legal basis alleged therefor in such detail as will permit a specific response thereto.” *Id.*; *see also* 5 U.S.C. § 554(b)(3) (giving respondents a right to notice of “the matters of fact and law asserted”).

If a respondent believes an OIP provides insufficient notice, the 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 such matter of fact or law [to be considered or determined] should be required to be made more definite.” 17 C.F.R. § 201.220(d). In determining whether an OIP provides adequate notice, the Commission distinguishes between the nature of the charges against a respondent and disclosure of evidence. *See Murray Sec. Corp.*, Exchange Act Release No. 5510, 1957 WL 52415, at *1 (May 2, 1957). A respondent is entitled to notice of the former but is not entitled to the latter. *Id.* An administrative law judge retains the discretion to order the Division to provide greater specificity even if a respondent fails to show that a more definite statement is required. *Id.* at *2; *see* Rules of Practice, Exchange Act Release No. 9795, 1972 WL 125354, at *1 (Sept. 27, 1972) (noting “the Commission’s policy [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”).

Because the OIP in this case requires an answer, the OIP must contain more than “a short and plain statement of the matters of fact and law to be considered and determined.” 17 C.F.R. § 201.200(b)(3). Instead, the OIP must “set forth the factual and legal basis alleged therefor in such detail as will permit a specific response thereto.” *Id.* Although the Commission has not explained the difference between these two requirements, the fact it has chosen to make this distinction means that when the OIP calls for answer, it must contain something different from simply a short and plain statement.¹

¹ Under the rules of civil procedure, motions for a more definite statement are disfavored because parties can make use of discovery in order to determine the facts behind the pleadings. *See New Lenox Indus., Inc. v. Fenton*, 510 F. Supp. 2d 893, 911 (M.D. Fla. 2007); *Tagare v. NYNEX Network Sys. Co.*, 921 F. Supp. 1146, 1153 (S.D.N.Y. 1996). The nature of discovery in Commission administrative proceedings, as compared to that under the rules of civil procedure, the unavailability of interrogatories in Commission proceedings, *see* Amendments to the Commission’s Rules of Practice, Exchange Act Release No. 78319, 81 Fed. Reg. 50212, 50233 (July 29, 2016), the timelines that govern Commission proceedings, *see* 17 C.F.R.

(continued...)

The allegation that Pruitt violated Section 13(b)(5), which prohibits knowingly circumventing a system of internal controls, essentially incorporates the relevant internal controls into the charged violation. *See* OIP at 10 (claiming that the failure to deliver invoices represented a “violation of a specific internal control of” the issuer). Because it is reasonable to require the Division to inform Pruitt of the statute or regulation the Division alleges he violated, it is reasonable to inform him which internal control forms the basis for the charge. This is especially true here, where the OIP alleges that Pruitt violated one “specific internal control” but the Division asserts that Pruitt violated at least three internal controls and perhaps more within a collection of almost 500 internal controls. The Division must rectify this ambiguity as described below. *Cf. Lincoln Labs., Inc. v. Savage Labs., Inc.*, 26 F.R.D. 141, 143 (D. Del. 1960) (holding that “Defendant should not be required to guess which of the plaintiff’s 60 trademarks he is supposed to be infringing when it would be a simple matter for the plaintiff to specify his pleadings in this respect.”).

The Division’s response to Pruitt’s argument about the allegedly falsified books and records is somewhat confusing and inconsistent. It purports to “[s]pecifically” describe the relevant books and records; yet, it goes on to assert that because the phrase books, records, and accounts is so broad and the issuer is so large, it cannot be expected to say which books, records, or accounts were falsified. Given the latter argument, the former attempt at specificity can only be regarded as providing a partial list of documents that fall within the terms of the book, records, and accounts allegations.

Further, as Pruitt asserts, the Division espouses what appears to be a nonspecific, “unbounded” interpretation of what constitutes books, records, and accounts. Given that the Division’s position could potentially include every e-mail and document within the investigative file, Pruitt is entitled to a measure of greater specificity. Because, however, he is not entitled to the disclosure of evidence, *see Murray Sec. Corp.*, 1957 WL 52415, at *1, the Division is not required to identify each document that constitutes a book, record, or account for purposes of Section 13(b)(2)(A) and Rule 13b2-1.

§ 200.360, and the distinction drawn in Rule 200(b)(3), combine to further suggest that whatever the standard for ruling on motions for more definite statement in Commission proceedings, that standard differs from that under the rules of civil procedure.

Within ten days, the Division shall submit:

- (1) A list of the internal control or controls that it asserts are relevant to the alleged violation of Exchange Act Section 13(b)(5); and
- (2) An explanation of the categories of documents that are implicated by the phrase “books, records, and accounts.” If the categories are limited to the three identified on pages 4 and 5 of its opposition the Division should so state. If there are additional categories, the Division should describe them specifically enough so that documents falling within the categories can be identified.

James E. Grimes
Administrative Law Judge