

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

Administrative Proceedings Rulings
Release No. 6528 / March 28, 2019

Administrative Proceeding
File No. 3-17950

In the Matter of
David Pruitt, CPA

**Order Requiring
More Definite Statement**

In this order, I attempt for a second—possibly third—time to resolve the dispute Respondent David Pruitt raises about the allegations in the OIP. Consistent with the Securities and Exchange Commission’s Rules of Practice, I determine that Pruitt’s objections are, in part, well taken. But first, some context.

1. *How did we get here?*

The Commission issued the order instituting proceedings (OIP) in this case in April 2017. The OIP alleges that Pruitt caused a violation of Section 13(b)(2)(A) of the Securities Exchange Act of 1934 and willfully violated Exchange Act Section 13(b)(5) and Exchange Act Rule 13b2–1.¹ Section 13(b)(2)(A) requires securities issuers to maintain “books, records, and accounts ... in reasonable detail, accurately and fairly reflect[ing] the transactions and dispositions of the [issuer’s] assets.”² 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).³ Rule 13b2–1 prohibits any

¹ OIP ¶¶ 43–45.

² 15 U.S.C. § 78m(b)(2)(A).

³ 15 U.S.C. § 78m(b)(5).

person from “directly or indirectly, falsify[ing] or caus[ing] to be falsified, any book, record or account subject to section 13(b)(2)(A).”⁴

According to the OIP, this proceeding concerns Pruitt’s alleged role in L3 Technologies, Inc.’s improper recognition of revenue at its Army Sustainment Division.⁵ Pruitt, who was then vice president of finance at the Army Sustainment Division, allegedly learned that L3 would recognize revenue when it generated a customer invoice.⁶ Although generated invoices were required to be delivered to the customer, Pruitt allegedly prevented delivery.⁷ And he allegedly took these steps because although he knew the customer would dispute the invoices, he wanted to reach a revenue-based threshold necessary to trigger a bonus.⁸ Paragraph 39 of the OIP alleges that “[t]he invoices had not been delivered to the [customer], in violation of a specific internal control ... that required delivery of invoices.”⁹ Once these circumstances were discovered, L3 had to amend its periodic Commission filings.¹⁰

In June 2017, Pruitt moved for a more definite statement, targeting the books and records he allegedly falsified or made inaccurate and the “specific internal control” referenced in paragraph 39 which the Division believes he circumvented.¹¹ I granted Pruitt’s motion in part and ordered the Division to identify the relevant internal controls and the categories of documents relating to the phrase *books, records, and accounts*.¹² The Division responded with a list of 16 internal controls and 17 categories of books, records, and accounts.¹³

⁴ 17 C.F.R. § 240.13b2–1.

⁵ OIP ¶ 1.

⁶ OIP ¶¶ 2, 20.

⁷ OIP ¶¶ 22–26.

⁸ OIP ¶¶ 9, 27.

⁹ OIP ¶ 39.

¹⁰ OIP ¶ 42.

¹¹ See *David Pruitt, CPA*, Admin. Proc. Rulings Release No. 4888, 2017 SEC LEXIS 1945, at *1–2 (ALJ June 23, 2017).

¹² *Id.* at *9.

¹³ See Letter from Paul G. Gizzi to John J. Carney (June 30, 2017).

In the course of litigating Pruitt's later motion for a ruling on the pleadings, the Division identified IR 4 as L3's internal control that required delivery of generated invoices.¹⁴ After I denied the motion for a ruling on the pleadings, Pruitt filed a motion to compel the Division to "definitively identify the specific internal control or controls" it alleges Pruitt circumvented.¹⁵ This motion led to a September 2017 telephonic conference during which Pruitt's counsel agreed that if the Division stuck with the 16 identified internal controls, Pruitt's concerns would be satisfied.¹⁶ Later, I ordered that if the Division wanted to add to the 16 identified controls, it would have to show cause why it should be allowed to do so.¹⁷

Over the next several months, I stayed this proceeding due to potential settlement, lifted the stay after the settlement fell through, and ratified my previous orders after the Commission ratified the appointments of its administrative law judges.¹⁸ But in June 2018, the Supreme Court decided *Lucia v. SEC*,¹⁹ and in August 2018 the Commission ordered that, as a result of *Lucia*, all pending proceedings had to start over again from the beginning.²⁰

Pruitt thus filed a new motion for more definite statement, asking for the specific books and records and the internal controls at issue.²¹ I granted the

¹⁴ See *David Pruitt, CPA*, Admin. Proc. Rulings Release No. 4937, 2017 SEC LEXIS 2309 (ALJ Aug. 1, 2017).

¹⁵ Mem. in Supp. of Mot. to Compel at 1 (Aug. 11, 2017).

¹⁶ Prehearing Tr. 38.

¹⁷ Prehearing Tr. 40; see *David Pruitt, CPA*, Admin. Proc. Rulings Release No. 5024, 2017 SEC LEXIS 2740 (ALJ Sept. 6, 2017).

¹⁸ See *David Pruitt, CPA*, Admin. Proc. Rulings Release No. 5599, 2018 SEC LEXIS 470, at *2, *12 (ALJ Feb. 14, 2018).

¹⁹ 138 S. Ct. 2044 (2018).

²⁰ See *Pending Admin. Proc.*, Securities Act Release No. 10536, 2018 WL 4003609, at *1 (Aug. 22, 2018). Under the Commission's order, the parties could have elected to proceed before a new administrative law judge or to rely on the previously developed record, *id.*, but they declined to exercise either option.

²¹ Mem. in Supp. of Mot. for More Definite Statement at 7.

motion in part.²² As before, I directed the Division to submit a list of the relevant internal control or controls and to explain the categories of documents relating to the phrase *books, records, and accounts*.²³ I also ordered that in the event Pruitt objected to the Division’s disclosure, he should file a letter explaining his objections.²⁴

The Division timely submitted a letter to Pruitt. Unlike before, the Division identified 40 relevant internal controls—not 16—and 21 general and specific categories of documents implicated by the phrase *books, records, and accounts*.²⁵

In contrast to September 2017, Pruitt is not satisfied with the Division’s response and has objected to it. Noting the more-than-doubling of identified internal controls, he asserts that the Division’s case regarding the internal controls “has been a constantly moving target.”²⁶ Pruitt notes that none of the 39 additional controls are listed in the OIP and were therefore not considered in connection with his earlier motion for a ruling on the pleadings.²⁷ He also argues that the OIP lacks any factual allegations to support any claim that he knowingly circumvented the 39 additional controls.²⁸

Pruitt also objects that the Division has identified categories of books and records so broadly that he cannot identify what is at issue.²⁹ Starting with the Division’s identification of L3’s general ledger, trial balance and balance sheet, and auditor’s work papers, Pruitt asserts that the identified

²² *David Pruitt, CPA*, Admin. Proc. Rulings Release No. 6421, 2018 SEC LEXIS 3588 (ALJ Dec. 20, 2018).

²³ *Id.* at *11–13.

²⁴ *Id.* at *14.

²⁵ See Letter from Paul G. Gizzi to John J. Carney (Feb. 13, 2019). In addition to identifying 16 internal controls during pre-*Lucia* litigation, the Division referenced 16 internal controls as recently as December 2018, when it opposed Pruitt’s motion for a ruling on the pleadings. See Opp’n to Mot. for Ruling on the Pleadings at 23.

²⁶ Letter from Jimmy Fokas at 2 (Feb. 21, 2019).

²⁷ *Id.* at 3.

²⁸ *Id.*

²⁹ *Id.* at 4–6.

categories encompass a potentially massive number of documents, many of which have nothing to do with him or the subsidiary for which he worked.³⁰ Next, he takes aim at the Division's identification of L3's accounting policies and procedures and internal controls documentation, saying that it is not clear from the OIP how he could have falsified these things.³¹ Finally, Pruitt faults the identification of e-mail correspondence and PowerPoint presentations, which could involve tens of thousands of documents.³²

The Division responds that Pruitt should not be permitted to rely on the fact that prior to *Lucia*, it identified only 16 controls.³³ It adds that 40 controls is merely a small subset of L3's 500 controls and it will prove how Pruitt violated the 40 controls.³⁴ The Division maintains that it has sufficiently identified categories of books and records and the OIP identifies most of the books and records at issue.³⁵ And, according to the Division, Pruitt is aware of the documents marked for identification during the investigation, and of investigative testimony discussing the relevant books and records.³⁶ Finally, the Division asserts that Pruitt should be ordered "to file an answer to the additional disclosure" it provided.³⁷

Following receipt of the Division's response, I held a prehearing conference to discuss Pruitt's objections and the requirements of Commission Rule of Practice 200. I asked the Division to identify where the OIP alleged that L3 had a system of internal accounting controls. The Division responded that the existence of that system can be inferred from the allegation that L3 is a large corporation with securities registered with the Commission.³⁸ It also referred to the paragraph which stated the legal conclusion that Pruitt

³⁰ *Id.* at 4.

³¹ *Id.* at 5.

³² *Id.*

³³ Letter from Paul G. Gizzi at 3 (Feb. 28, 2019).

³⁴ *Id.* at 4.

³⁵ *Id.* at 4.

³⁶ *Id.*

³⁷ *Id.* at 5.

³⁸ See OIP ¶ 5.

violated Section 13(b)(5).³⁹ In response to additional questions, the Division asserted that quoting the statutory language and alleging that L3 is a large corporate issuer is sufficient to allege that it had a system of internal accounting controls.

2. *What does Rule 200 require?*

The current dispute began when Pruitt moved for a more definite statement. Such motions are governed by Rule of Practice 220(d), which requires the movant to “state 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.”⁴⁰ Because 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,”⁴¹ administrative law judges may order the Division to provide greater specificity even if a respondent fails to satisfy this standard.⁴² But before considering whether to exercise discretion to order a more definite statement where one is not required, I determine what must be included in an OIP in the first place.

The Commission has held that a respondent in an administrative proceeding is entitled to notice of the charges against him but not to the disclosure of evidence.⁴³ Although Commission administrative proceedings are now initiated under Rule of Practice 200 by the issuance of an OIP, they were originally initiated through the issuance of a notice of hearing. As promulgated in 1936, Rule of Practice III(b) required that a notice of hearing “include a short and simple statement of the matters to be considered and determined.”⁴⁴ This formulation echoed language in Rule 25 of the Federal

³⁹ See OIP ¶ 44.

⁴⁰ 17 C.F.R. § 201.220(d).

⁴¹ Miscellaneous Amendments, 37 Fed. Reg. 23,827, 23,827 (Nov. 9, 1972).

⁴² *Murray Sec. Corp.*, Exchange Act Release No. 5510, 1957 WL 52415, at *2 (May 2, 1957); 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).

⁴³ See *Murray Sec.*, 1957 WL 52415, at *1.

⁴⁴ Rules of Practice as Amended November 4, 1936, 1 Fed. Reg. 2035, 2036 (Nov. 7, 1936). This citation is from an archived volume of the Federal

(continued...)

Equity Rules of 1912, which then governed the contents of a complaint in federal district court and which were supplanted in 1938 by the Federal Rules of Civil Procedure. Rule 25 required that a complaint contain “a short and simple statement of the ultimate facts upon which the plaintiff asks relief, omitting any mere statement of evidence.”⁴⁵

When the Commission revised its rules of practice in 1946, following the enactment of the Administrative Procedure Act, it retained the *short and simple statement* formulation. Rule III(a), as amended in 1946, directed that a notice of hearing “be accompanied by a short and simple statement of the matters of fact and law to be considered and determined.”⁴⁶

In 1960, as part of a wholesale revision of the rules of practice, the Commission moved the requirements in Rule III(a) to a new Rule 6(a). Rule 6(a) created a new distinction between charging documents that required an answer and those that did not. It provided that if a charging document—referred to as an *order for proceedings*—did not require an answer, a party “entitled to notice” merely had to be “furnished” in the order with “a short and simple statement of the matters of fact and law to be considered and determined.”⁴⁷ But if the order for proceedings required an answer, Rule 6(a) required that it “set forth the action proposed and the factual and legal basis alleged therefor in such detail as will permit a specific response thereto.”⁴⁸ Rule 6(a) thus retained the *short and simple* formulation, but only for a specific class of cases. For all other cases, something more than a short and simple statement was required.

In 1995, the Commission comprehensively revised and renumbered its rules.⁴⁹ The requirements of Rule 6(a) were moved to their current location,

Register made available online by the Government Publishing Office at <https://www.govinfo.gov/content/pkg/FR-1936-11-07/pdf/FR-1936-11-07.pdf>. A different citation, 1 Fed. Reg. 1753, appears on WestLaw and other databases.

⁴⁵ Fed. Equity R. 25.

⁴⁶ Part 201 – Rules of Practice, 11 Fed. Reg. 177A-718, 177A-723–24 (Sept. 11, 1946).

⁴⁷ Rules and Regulations, 25 Fed. Reg. 6719, 6729 (July 15, 1960).

⁴⁸ *Id.*

⁴⁹ See Rules of Practice, 60 Fed. Reg. 32,738 (June 23, 1995).

Rule 200(b), which maintained the distinction recognized in 1960 between orders requiring an answer and those that do not.⁵⁰ Rule 200(b)(3), which has not been amended since 1995, contains two clauses. Under the first clause of subsection (b)(3), if an OIP does not require an answer, it need only “[c]ontain a short and plain statement of the matters of fact and law to be considered and determined.”⁵¹ This change from a *short and simple* statement to a *short and plain* statement follows the language in Federal Rule of Civil Procedure 8(a)(2), which provides that a complaint must contain “a short and plain statement of the claim showing that the pleader is entitled to relief.”

Under the second clause of Rule 200(b)(3), however, if the OIP requires an answer under Rule 220, it must “set forth the factual and legal basis alleged therefor in such *detail* as will permit a *specific* response thereto.”⁵² Rule 220 in turn requires a respondent to “specifically admit, deny, or state that the party does not have, and is unable to obtain, sufficient information to admit or deny each allegation in the [OIP].”⁵³

So far as can be determined, the Commission has not explained the reason it created the distinction between an OIP that requires an answer and one that does not. Like Federal Rule of Civil Procedure 8(a)(2), the first clause of Rule 200(b)(3) does not explicitly require detailed factual allegations.⁵⁴ The second clause of Rule 200(b)(3) does, however. Given this distinction, and the fact that the Commission created it after several years of experience with charging documents that made no distinction, the second clause cannot be read as merely superfluous.⁵⁵

And the pre-1995 *short and simple* statement formulation and the similar post-1995 *short and plain* statement formulation for OIPs not

⁵⁰ *Id.* at 32,756–57.

⁵¹ 17 C.F.R. § 201.200(b)(3).

⁵² *Id.* (emphasis added).

⁵³ 17 C.F.R. § 201.220(c). The 1960 version of the Commission’s rules contained the same specificity requirement for an answer. 25 Fed. Reg. at 6730.

⁵⁴ *Cf. Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009).

⁵⁵ *Cf. United States v. CITGO Petroleum Corp.*, 801 F.3d 477, 485 (5th Cir. 2015) (“Regulations, like statutes, must be ‘construed so that effect is given to all [their] provisions, so that no part will be inoperative or superfluous, void or insignificant.’” (quoting *Corley v. United States*, 556 U.S. 303, 314 (2009))).

requiring an answer echo the requirements of Federal Rule of Civil Procedure 8(a)(2). The Commission’s consistent use of language mirroring federal practice—whether under the previous Federal Equity Rules or current Federal Rules of Civil Procedure—strongly suggests the intent to emulate district court pleading standards.⁵⁶ Indeed, it is difficult to imagine that anyone familiar with federal practice would use the phrase *short and plain* without intending to invoke Rule 8.

Further demonstrating this intent, the Commission amended its rules in 2016 but retained the short-and-plain statement formulation. When the Commission amended its rules in 1960 and 1995, the then prevailing standard for Rule 8 did not require dismissal of a complaint “for failure to state a claim unless it appear[ed] beyond doubt that the plaintiff [could] prove no set of facts in support of his claim which would entitle him to relief.”⁵⁷ Under this standard, dismissal was improper even when “the complaint failed to set forth specific facts to support its general allegations.”⁵⁸ That standard prevailed until the Supreme Court abrogated it in 2007 in favor of a plausibility standard.⁵⁹ Despite the Supreme Court’s determination in 2007 that Rule 8(a)(2)’s short-and-plain statement requirement includes a plausibility standard, however, the Commission retained the short-and-plain formulation in 2016.

And when it retained the short-and-plain formulation, the Commission also chose to allow for motions for a ruling on the pleadings under Rule 250(a)—a procedural device it has termed “analogous to Rules 12(b)(6) and

⁵⁶ Unlike Federal Rule of Civil Procedure 8(a)(2), the first clause of Rule 200(b)(3) does not contain explicit language requiring that the Division’s claim be stated in a manner showing that it is entitled to relief. However, Rule 200(b)(3)’s requirement that the OIP contain “the matters of fact and law to be considered and determined” necessarily means that the Division’s allegations must make clear the factual and legal issues at stake, beyond “labels and conclusions,” “a formulaic recitation of the elements of a cause of action,” or “naked assertions devoid of further factual enhancement.” *Iqbal*, 556 U.S. at 678 (internal quotation marks omitted).

⁵⁷ *Conley v. Gibson*, 355 U.S. 41, 45–46 (1957).

⁵⁸ *Id.* at 47.

⁵⁹ *See Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556–60 (2007); *see also Iqbal*, 556 U.S. at 678.

12(c) of the Federal Rules of Civil Procedure.”⁶⁰ This procedure “permits a respondent to seek a ruling as a matter of law based on the factual allegations in the OIP.”⁶¹ In context, this procedure makes sense only if it was contemplated that something akin to district court pleading standards would apply.⁶² Even putting aside the language of Rule 200(b)(3), therefore, current administrative practice, as evidenced by the Commission’s recent amendments, calls for a closer evaluation of the pleading standards in administrative pleadings.

Additionally, the “pleading standard” under Rule 8(a)(2) “relies on liberal discovery rules and summary judgment motions to define disputed facts and issues and to dispose of unmeritorious claims.”⁶³ Discovery in Commission administrative proceeding, however, is in many ways less liberal than in district court.⁶⁴ And the Commission disfavors summary disposition.⁶⁵ Adopting the distinction in Rule 200(b)(3)—and maintaining it in 2016—seemingly represents a recognition of the differences between district court and Commission proceedings.⁶⁶

⁶⁰ Amendments to the Commission’s Rules of Practice, 81 Fed. Reg. 50,212, 50,224 n.110 (July 29, 2016); *see* 17 C.F.R. § 201.250(a).

⁶¹ 81 Fed. Reg. at 50,224.

⁶² *Cf. Am. Fed’n of Gov’t Emps., Local 2782 v. FLRA*, 803 F.2d 737, 740 (D.C. Cir. 1986) (“It is a generally accepted precept of interpretation that statutes or regulations are to be read as a whole, with each part or section ... construed in connection with every other part or section.” (internal quotation marks omitted)).

⁶³ *Barrett v. Forest Labs., Inc.*, 39 F. Supp. 3d 407, 432 (S.D.N.Y. 2014) (quoting *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 512 (2002)); *cf. Swimwear Sol., Inc. v. Orlando Bathing Suit, LLC*, 309 F. Supp. 3d 1022, 1044 (D. Kan. 2018) (“Motions for a more definite statement are generally disfavored in light of liberal discovery available under the federal rules”).

⁶⁴ *See* 81 Fed. Reg. at 50,216.

⁶⁵ *See id.* at 50,225 & nn.116, 118.

⁶⁶ Respondents’ lack of access to the full range of discovery devices available in district court means that district court decisions denying specificity-based motions to dismiss based on the availability of discovery are not completely relevant in the context of Commission proceedings. *See SEC v. Collins & Aikman Corp.*, 524 F. Supp. 2d 477, 497 (S.D.N.Y. 2007).

Giving effect, therefore, to Rule 200(b)(3)'s distinction between OIPs requiring an answer and those that do not, and the words *detail* and *specific* in its second clause, it must be that OIPs requiring an answer must, at a minimum, provide more information—more detail allowing more specificity—than what would be required under Rule 8(a)(2).⁶⁷ Harmonizing the language of Rule 200(b)(3)'s first clause and its similarity to Rule 8(a)(2) with the fact that Rule 200(b)(3)'s second clause requires more detail than the first clause, means that an OIP that requires an answer must provide plausible factual allegations—the Rule 8(a)(2) requirement in district court—plus additional details when an answer is required. Recognizing that the second clause of Rule 200(b)(3) does not include language similar to Federal Rule of Civil Procedure 9(b), this means in practical terms that the requirements of Rule 200(b)(3) fall somewhere between Rule 8(a)(2) and Rule 9(b).

3. *This detail-and-specificity requirement raises concerns about the OIP in this case.*

3.1. *The OIP mentions only one, unnamed internal control.*

The OIP alleges that Pruitt violated Section 13(b)(5), which prohibits circumventing a system of internal accounting controls.⁶⁸ The OIP, however,

⁶⁷ A more practical and efficient approach might be to adopt a standard akin to Federal Rule of Civil Procedure 9(b), which provides that certain allegations must be “state[d] with particularity.” Indeed, one reason for Rule 9(b)'s particularity requirement, “enabl[ing] the defendant to respond specifically and quickly to the potentially damaging allegations,” *United States ex rel. Costner v. United States*, 317 F.3d 883, 888 (8th Cir. 2003), is consistent with the Commission's policy of “encourage[ing] ... the [prehearing] exchange of relevant information ... to expedite proceedings, arrive at settlements or simplification of the issues and assur[ing] fairness to respondents,” 37 Fed. Reg. at 23,827. One advantage of following this standard would be that, unlike in the current circumstance surrounding OIPs that require an answer, there is a robust body of case law interpreting the requirements of Rule 9(b). Cutting against these considerations, however, is the fact that Rule 200(b)(3), which contains language similar to Federal Rule of Civil Procedure 8(a)(2), does not contain language similar to Rule 9(b).

⁶⁸ OIP ¶ 44; see 15 U.S.C. § 78m(b)(5). Although there are three ways to violate Section 13(b)(5), see *SEC v. Nacchio*, 438 F. Supp. 2d 1266, 1283 (D. Colo. 2006), the Division appears to be proceeding on the theory that Pruitt circumvented a system of internal controls. See Opp'n to Mot. for Ruling on the Pleadings at 22 (Dec. 21, 2018). And as noted, the parties' dispute has long centered on the particular internal controls at issue.

contains only one factual allegation related to L3's internal accounting controls. In a section of the OIP dealing with L3's internal investigation, the OIP alludes to a single, unnamed internal control, saying "The invoices had not been delivered ... in violation of a specific internal control ... that required delivery of invoices."⁶⁹ There is no mention, implied or express, of another internal control. And aside from the allegation about the unnamed internal control, the OIP merely alludes to L3's overall system of accounting controls. It mentions that (1) the controller of an affiliated subsidiary "recognized that not submitting invoices through" a web-based system used by Defense Department vendors "would violate certain 'work procedures,'" (2) a contract manager suspected Pruitt was acting to "avoid Corporate policy and try to 'hide' this from the auditors,"⁷⁰ and (3) L3 had auditors, who reviewed an accounts receivable balance.⁷¹

Yet, the Division argues that Pruitt violated Section 13(b)(5) "by knowingly circumventing L3's internal controls"⁷² and has claimed that Pruitt violated 16, and now 40, of those internal controls. It asserts that "the OIP plainly describes how Pruitt's conduct violated the internal controls provision of the securities laws, and is not limited to circumvention of only one internal control."⁷³ But the only cited support for this latter assertion is the bare legal allegation that Pruitt violated the statute.⁷⁴ If simply quoting the statutory language is insufficient under Rule of Civil Procedure 8(a)(2)⁷⁵ it must be insufficient to meet the requirements of Rule of Practice 200(b) in a case involving an OIP requiring an answer.⁷⁶

⁶⁹ OIP ¶ 39.

⁷⁰ OIP ¶¶ 23, 24.

⁷¹ OIP ¶ 37. Pruitt has not disputed that the OIP alleges, directly or by inference, that L3 has a system of internal accounting controls.

⁷² Opp'n to Mot. for Ruling on the Pleadings at 22 (emphasis added).

⁷³ Opp'n to Mot. for More Definite Statement at 11 (citing OIP ¶ 44).

⁷⁴ *Id.*

⁷⁵ *See Iqbal*, 556 U.S. at 678.

⁷⁶ *Cf. SEC v. DiMaria*, 207 F. Supp. 3d 343, 360 n.7 (S.D.N.Y. 2016) (finding the "bare legal conclusion" that a defendant "knowingly circumvented or knowingly failed to implement a system of internal accounting controls" would be insufficient without "specific factual allegations supporting it").

Because the violation of internal controls is the basis for the Section 13(b)(5) claim, the Division cannot, in responding to Pruitt’s request for specificity, expand the OIP from one unnamed control to 39 more that are neither mentioned nor alluded to in the OIP.⁷⁷ The Division’s case under Section 13(b)(5) is limited, by the terms of the OIP, to proving that Pruitt willfully violated that internal control. Within ten days, the Division shall confirm to Pruitt which internal control is at issue.⁷⁸ If the Division seeks to proceed on a theory that Pruitt violated internal controls in addition to Invoicing and Receivables control 4, it shall within ten days move to amend the OIP to allege the additional internal controls allegedly violated together with facts showing each internal control was allegedly violated.⁷⁹

⁷⁷ See *SEC v. Patel*, No. 07-cv-39, 2009 WL 3151143, at *25–27 (D.N.H. Sept. 30, 2009) (reducing under Rule 9(b) a Section 13(b)(5) count to falsification of books and records because the complaint did not state the internal controls allegedly violated) (relying on *SEC v. Berry*, 580 F. Supp. 2d 911, 924–25 (N.D. Cal. 2008)); cf. *SEC v. Bankatlantic Bancorp, Inc.*, No. 12-cv-60082, 2012 WL 1936112, at *24 (S.D. Fla. May 29, 2012) (finding insufficient under Rule 9(b) a complaint that “simply re-state[d] the statutory language without supporting factual allegations” in a case involving an alleged failure to maintain a system of internal accounting controls); *SEC v. Das*, No. 10-cv-102, 2010 WL 4615336, at *9 (D. Neb. Nov. 4, 2010) (finding a complaint sufficient under Rule 9(b) because “[u]nlike *Berry*,” the complaint “states generally the controls that were violated and describes how Defendants failed to meet the requirements”); *SEC v. Patel*, No. 07-cv-39, 2008 WL 781912, at *17 (D.N.H. Mar. 24, 2008) (noting in a case under Section 13(b)(2)(B) that the Commission did not “point to any factual allegations in the complaint concerning [an issuer’s] system of internal accounting controls, and ... d[id] not point to any factual allegations concerning [a defendant’s] role in establishing or administering any such system of accounting controls”); *SEC v. Dauplaise*, No. 05-cv-1391, 2006 WL 449175, at *8 (M.D. Fla. Feb. 22, 2006) (noting that “other than the conclusory allegation ... (which basically restates the language of the Rule), the SEC’s Complaint makes no reference to [the issuer’s] books, records or accounts”).

⁷⁸ See 17 C.F.R. § 201.222(a). In its February 13, 2019 letter, the Division stated that the control specifically referenced in the OIP is Invoicing and Receivables control 4. Letter from Paul G. Gizzi to John J. Carney at 2 n.1 (Feb. 13, 2019).

⁷⁹ See 17 C.F.R. § 201.200(d)(2); *James S. Tagliaferri*, Exchange Act Release No. 75820, 2015 WL 5139389, at *2 n.14 (Sept. 2, 2015) (“In construing our rules, we have been guided by the liberal spirit of the Federal

(continued...)

3.2. *The Division must supplement its books, records, and accounts disclosure.*

The OIP also alleges that Pruitt caused L3's violation of Section 13(b)(2)(A), which obligates issuers to maintain "books, records, and accounts ... in reasonable detail, accurately and fairly reflect[ing] the transactions and dispositions of [L3's] assets."⁸⁰ The Division identifies 21 categories of items in its letter. Pruitt objects to the following eight identified categories:

1. *L3's general ledger*
2. *L3's trial balance and balance sheet*
3. *L3's consolidation schedules (showing how the financial statements of L3's Army Sustainment Division rolled up through L3's consolidated financial statements)*
4. *Operations review PowerPoints for L3's Army Sustainment Division, Logistics Solutions, and Aerospace Systems that reflect the improperly recorded revenue in Q4 2013 and Q1 2014*
5. *Email correspondence and other internal documents referencing the improper revenue recognition*
6. *Portions of L3's auditor's work papers that reflect information provided by L3*
7. *L3 accounting policies and procedures*
8. *L3 internal controls documentation*

Three of these categories can be eliminated from consideration. During the March 14 conference, the Division confirmed that the fifth category, relating to certain emails, is duplicative of another identified category to which Pruitt does not object. And because the phrase *books, records, or accounts* only includes "those [books, records, and accounts] which 'in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer,'"⁸¹ neither L3's accounting policies and

Rules of Civil Procedure with respect to amendment." (internal quotation marks omitted)); *cf. SEC v. Lucent Techs., Inc.*, 363 F. Supp. 2d 708, 728 (D.N.J. 2005) (dismissing a Section 13(b)(5) count with leave to amend).

⁸⁰ OIP ¶ 43; *see* 15 U.S.C. § 78m(b)(2)(A).

⁸¹ *SEC v. Adoni*, 60 F. Supp. 2d 401, 411 (D.N.J. 1999).

procedures nor its internal controls documentation could be encompassed within Section 13(b)(2)(A). Indeed, it is hard to conceive how an issuer's policies or its internal controls documentation could "reflect the transactions and dispositions of [an issuer's] assets" rather than dictate *how* those transactions and dispositions are reflected. To be sure, a policy could be violated when a person causes an issuer's books and record to not accurately and fairly reflect the issuer's transactions, but that would not mean the policy itself would inaccurately and unfairly reflect those transactions. Additionally, nothing in the OIP suggests that Pruitt was responsible for drafting the policies, procedures, or internal controls.

This leaves five categories identified by the Division. Although none of the five remaining categories is specifically described in the OIP,⁸² Pruitt's complaint is that the categories are so broad that he does not know what documents are at issue. Given Pruitt's argument, the question is whether, if the Division had included the categories in the OIP, the allegations in the OIP would have provided enough detail to allow a specific response.

⁸² The OIP includes mention of the following 7 items or categories of items (found at the indicated paragraphs) that might plausibly be included within the phrase *books, records, and accounts*:

69 undelivered invoices, OIP ¶¶ 2, 23, 24, 27, 31–35, 37–38, 39

L3's Form 10-K for FY 2013 and Form 10-Q for first quarter of 2014, OIP ¶¶ 3, 41, 42

Estimates at completion, OIP ¶ 17

Entry of \$8.8 million of accruals, OIP ¶¶ 28, 29

Document Pruitt emailed to controller January 14, 2014, OIP ¶¶ 31–32

Explanation "communicated" to L3's auditor, OIP ¶¶ 37–38

An e-mail: (1) sent by Pruitt Monday, December 23, 2013, OIP ¶ 22, and,

(2) sent from Army Contracting Officer and modified at Pruitt's request, OIP ¶¶ 35–36.

It seems self-evident that with regard to the remaining five categories, the relevant allegedly inaccurate documents are those that reported Army Sustainment Division revenue or its revenue as part of L3's revenue.⁸³ In the abstract, the Division's letter gives Pruitt sufficient information to respond to the OIP because it identifies the things that Pruitt caused to be inaccurate.

On the other hand, the OIP alleges that L3 had \$12.6 billion in sales in fiscal year 2013.⁸⁴ L3's general ledger, balance sheet, consolidation schedules, and auditor's work papers must encompass a sizable number of documents. Given Pruitt's somewhat limited access to discovery devices and the number of times I have dealt with this issue, and in the interest of fairness, simplifying the issues, and expediting this proceeding, I order additional disclosure in the exercise of discretion.⁸⁵ Within ten days, the Division shall provide Pruitt with detail sufficient to narrow the portions of L3's general ledger, trial balance and balance sheet, consolidation schedules, and auditor's work papers that the Division believes Pruitt caused to not "accurately and fairly reflect the transactions and dispositions of [L3's] assets."⁸⁶

Within 14 days after the Division submits its filing in response to this order, Pruitt shall file his answer to the new information provided by the Division.⁸⁷

James E. Grimes
Administrative Law Judge

⁸³ See OIP ¶¶ 2–3, 39–42 (alleging that Pruitt's actions caused L3 to improperly recognize revenue and resulted in inaccuracies in certain periodic reports).

⁸⁴ OIP ¶ 5.

⁸⁵ See *Murray Sec.*, 1957 WL 52415, at *2; 37 Fed. Reg. at 23,827; 17 C.F.R. §§ 201.200(b)(3), .222(a).

⁸⁶ *Adoni*, 60 F. Supp. 2d at 411; cf. *SEC v. Miller*, No. 17-cv-00897, 2017 WL 5891050, at *7 (C.D. Cal. Nov. 15, 2017) (holding under Rule 9(b) that a complaint was insufficiently pleaded because it failed to "identify which, if any, of [the] possible candidates are the allegedly falsified books, records, or accounts"). This requirement does not apply to the operations review PowerPoints.

⁸⁷ 17 C.F.R. § 201.220(d).