ADMINISTRATIVE PROCEEDING
FILE NO. 3-17950

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of,

DAVID PRUITT, CPA,

Respondent.

MOTION TO QUASH SUBPOENAS ISSUED TO THE SECURITIES AND EXCHANGE COMMISSION'S DIVISION OF CORPORATION FINANCE AND OFFICE OF CHIEF ACCOUNTANT

INTRODUCTION

The Division of Enforcement (the "Division") and the Office of Litigation and Administrative Practice ("OLAP") within the Office of the General Counsel move to quash the subpoenas that Respondent has served on the Securities and Exchange Commission ("Commission or SEC") Division of Corporation Finance ("Corp Fin") and the Office of the Chief Accountant ("OCA"). The subpoenas seek over forty years' worth of voluminous materials that are simply irrelevant to the issues to be resolved in this administrative proceeding. The Division and OLAP move to quash the subpoenas because 1) the documents sought are not relevant to any material issue in dispute in this proceeding, 2) they are overbroad and unduly burdensome, and 3) they seek documents protected from disclosure by multiple privileges.[1]

[1] The General Counsel is authorized to "assert governmental privileges on behalf of the Commission in litigation where the Commission appears as a party or in response to third party subpoenas." 17 C.F.R. § 200.30-14(f). When subpoenas in administrative proceedings request documents from divisions and offices other than, or in addition to, the Division, the OLAP may appear to protect privileged information or documents. *See, e.g.*, *In the Matter of Putnam Inv.*

These subpoenas represent Respondent's effort to confuse the issues in this proceeding and distract attention from the issues to be decided: whether Respondent's conduct caused L3 Technologies, Inc. ("L3") to violate the Securities Exchange Act of 1934 (the "Exchange Act") and whether Respondent himself violated the Exchange Act. The answer to those questions will be resolved at the hearing based solely on Respondent's conduct, and not through reference to materials that have nothing to do with Respondent's conduct.

BACKGROUND

A. The Order Instituting Proceedings

On April 28, 2017, the Commission issued an order instituting proceedings (the "OIP") against Respondent David Pruitt. Respondent served as the former Vice President of Finance for the Army Sustainment Division ("ASD") of L3, a major United States government contractor, from January 2013 until he was reassigned in January 2014. The OIP alleges that, in December 2013, Respondent instructed a subordinate to create invoices related to unresolved claims under an aircraft maintenance contract with the U.S. Army in L3's internal accounting system, and withhold delivery of those invoices to the U.S. Army. The vast majority of these unsent invoices were discovered at L3's offices approximately six months later during an internal investigation. As a result of Respondent's conduct, L3 improperly recognized the revenue associated with the invoices, approximately $17.9 million.

The Division charges that through his conduct, Respondent: (1) caused L3's violations of Section 13(b)(2)(A) of the Exchange Act, which requires an issuer to make and keep books, records and accounts that, in reasonable detail, accurately and fairly reflect the transactions and

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Mgmt., LLC, A.P. File No. 3-11317, Rel. No. 613, 2004 WL 1175274, at *1 n.1 (Mar. 26, 2004) (OGC represents OCIE regarding motion to quash subpoena). The Associate General Counsel for Litigation and Administrative Practice has delegated authority to assert governmental privileges.

dispositions of the assets of the issuer; (2) willfully violated Section 13(b)(5) of the Exchange Act, which prohibits any person from knowingly circumventing a system of internal accounting controls or knowingly falsifying any book, record or account of an issuer; and (3) willfully violated Rule 13b2-1 of the Exchange Act, which prohibits any person from, directly or indirectly, falsifying or causing to be falsified, any book, record or account that an issuer is required to maintain under the Exchange Act.

B. Relevant Procedural History

On July 14, 2017, Respondent filed a motion for a ruling on the pleadings pursuant to Rule of Practice 250(a). Based upon a 1981 comment from former Commission Chairman Harold M. Williams, Respondent argued that the books and records charges should be dismissed because the dollar amounts at issue were *de minimis* to L3's overall revenue.

On August 1, 2017, the Court denied the motion. In a decision that carefully examined the plain text, legislative history, and Congressional intent behind the books and records provisions of the Exchange Act, the Court rejected Respondent's *de minimis* argument. Order Denying Motion for Ruling on the Pleadings, Admin. Proc. Rulings Release No. 4937, *In the Matter of David Pruitt, CPA*, Admin. Proc. File No. 3-17950, at 4 (Aug. 1 2017) (the "Rule 250 Order"). The Court opined that "the *de minimis* exemption provides a safe harbor for an issuer that 'records ... transactions in conformity with accepted methods of recording economic events,' not an issuer whose officers intentionally recognize revenue that they allegedly know should not be recognized." *Id.* (citation omitted). Thus, the *de minimis* exemption that Respondent sought to invoke "is not a free pass to intentionally misrecognize just a little bit of revenue. Intentionally misrecognizing $17.9 million in revenue is not 'so insignificant that [it] may [be] overlook[ed] ... in deciding an issue or case.'" *Id.* (quoting *De Minimis*, Black's Law

Dictionary (10th ed. 2014)) (alteration in original).

Following the Commission's Order issued in *Matter of Pending Administrative Proceedings*, Admin Proc. Release No. 33-10440 (Nov. 30, 2017), the Court issued an order directing the parties to submit a brief addressing whether the Court should ratify or revise any prior actions that the Court had taken in this proceeding. Order, Admin. Proc. Rulings Release No. 5362, *In the Matter of David Pruitt, CPA*, Admin. Proc. File No. 3-17950, at 1 (Dec. 11 2017). In response, Respondent filed a motion asking the Court – for the second time – to dismiss the books and records claims based on the purported *de minimis* exception. The Court again rejected Respondent's argument. Order Ratifying Prior Actions, Admin. Proc. Rulings Release No. 5599, *In the Matter of David Pruitt, CPA*, Admin. Proc. File No. 3-17950, at 3-4 (Feb. 14, 2018).

The Court indicated that it was "not convinced by Pruitt's arguments," and would "adhere to [its] prior ruling that the *de minimis* exception to Section 13(b)(1)(A) does not allow an issuer's officers to 'intentionally recognize revenue that they allegedly know should not be recognized.'" *Id.* at 3 (quoting the Rule 250 Order). The Court also rejected Respondent's attempt to impose a purely quantitative standard for assessing the "reasonable detail" requirement of Section 13(b)(2)(A), noting that Respondent "essentially argues for a materiality standard." *Id.* at 4. The Court also opined that "Pruitt takes Chairman Williams' comments about Commission policy out of context. Before discussing the reasonableness standard, Chairman Williams explained why materiality was not the test under Section 13(b)(2)(A)." *Id.* The Court continued that "Chairman Williams explained that establishing a percentage threshold of the sort Pruitt proposes would not provide a 'realistic standard' because '[p]rocedures designed only to uncover deficiencies in amounts material for financial statement purposes

would be useless for internal control purposes'" (quoting 46 Fed. Reg. at 11,546). *Id.* Thus, "[a] set of controls that permitted 'omissions or errors of many thousands or even millions of dollars would not represent, by any accepted standard, adequate records and controls.'" *Id.* Finally, the Court observed that "Pruitt's assertion raises the question of whether prudent officials would be as unconcerned as he claims if they knew the revenue was recognized by officers who knew they were violating company policy." *Id.* at 5.

On March 19, 2018, Respondent served nearly identical subpoenas on the Division seeking documents from Corp Fin and OCA. The subpoenas request that Corp Fin and OCA produce "[a]ll Documents and Communications" (as defined in the subpoenas) created between January 1, 1977 and the present related to: a) communications with L3 regarding guidance sought by L3 (without any subject matter limitation) (*see* Subpoena Request No. 1); b) Corp Fin's and OCA's internal analyses and reviews regarding the phrase "reasonable detail" in Section 13(b)(2)(A) (*see* Subpoena Request No. 2); c) Corp Fin's and OCA's correspondence with registrants and their auditors regarding the phrase "reasonable detail" in Section 13(b)(2)(A) (*see* Subpoena Request No. 3); d) Requests by registrants and their auditors for Corp Fin or OCA guidance regarding the phrase "such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs." (*see* Subpoena Request No. 4); (e) Corp Fin's and OCA's internal analyses and reviews regarding the purported *de minimis* exception to Section 13(b)(2)(A) (*see* Subpoena Request No. 5); and (f) Corp Fin's and OCA's correspondence with registrants and their auditors regarding the purported *de* minimis exception to Section 13(b)(2)(A) (*see* Subpoena Request No. 6). Respondent's subpoenas seek to utilize discovery to resurrect a twice rejected legal argument.

ARGUMENT

I. The Requested Subpoenas Seek Documents That Are Irrelevant and Immaterial.

Pursuant to Rule of Practice 232(e)(2), ALJs have the authority to quash a document subpoena where compliance "would be unreasonable, oppressive, unduly burdensome or would unduly delay the hearing." *Matter of John M. Schulzetenberg (Private Proceeding)*, Admin. Proc. File No. 3-6881, Release No. 286, 1988 SEC LEXIS 5240, at * 1 (Feb. 1, 1988).

None of the six requests contained within Respondent's subpoenas seek relevant information. Subpoena Request Nos. two through six seek: 1) the production of Corp Fin and OCA's internal analyses and interpretations regarding the phrases "reasonable detail" and "such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs," as well as the purported *de minimis* exemption and 2) documents regarding communications with other registrants and auditors regarding those issues. Because the staff's views do not constitute Commission policy, these documents are not relevant to this case.[2] *See In the Matter of George Salloum*, Admin. Proc. File No. 3-7402, Release No. 35563, 1995 WL 215268 (April 5, 1995). The Court has already ruled – on multiple occasions – regarding the contours of the *de minimis* exemption based on the text of Section 13(b)(2)(A) of the Exchange Act, its legislative history, and official Commission policy statements. The staff's analyses are simply not relevant to a determination of the issues in this proceeding – *i.e.*, whether Respondent's conduct violated or caused violations of the securities laws as alleged in the OIP. Moreover, Respondent cannot plausibly claim to have relied on staff analyses or

[2] Staff opinions "do not constitute an official expression of the [SEC's] views." 17 C.F.R. § 202.1(d). The Commission expresses policy through issuance of rules and regulations. 17 C.F.R. § 202.1. Statements of SEC staff are not statements of the SEC, which acts as a collegial body through its Chairman and Commissioners. *See, e.g., SEC v. National Student Mktg. Corp.*, 68 F.R.D. 157, 160 (D.C.C. 1975).

communications between the Commission staff and other registrants that he did not have access to at the time he committed the accounting misconduct described in the OIP. *See SEC v. Bank of Am. Corp.*, No. 09 Civ. 6829(JSR), 2009 WL 4797741, at *1 (S.D.N.Y. Dec. 8, 2009) (denying motion to compel production of Commission's internal documents and communications with third parties on the grounds that defendant could not possibly have relied on those documents).

Respondent's requests for documents and communications related to requests by L3 for guidance also seek irrelevant information. *See* Subpoena Requests No. 1. As a threshold matter, although the requests seek documents covering a period exceeding 40 years – from 1977 through the present, Respondent did not start working for ASD (*i.e.*, the relevant L3 division) until January 2013. Additionally, Respondent's accounting misconduct alleged in the OIP occurred in late 2013 and early 2014. And with respect to the 2013 and 2014 time period, there is no evidence that Respondent relied on communications between the Commission and L3 in support of his decision to recognize revenue or withhold invoices from the U.S. Army.

Accordingly, the Court should quash Respondent's subpoenas on the grounds that they seek information that is irrelevant to the issues to be resolved in this proceeding.

II. The Requests are Overbroad and Unduly Burdensome

The six Subpoena Requests to OCA and Corp Fin are also overly broad and unduly burdensome. The requests seek materials over a forty-year period without any attempt to identify any specific evidence relevant to the issues in this proceeding. The Commission does not maintain the requested documents in any central filing system; to locate responsive materials would require a very broad search of email records, several internal SEC systems, and paper files in offsite storage. For OCA, the search would include its internal consultation system and its Enforcement Liaison mailbox. For Corp Fin, the search would involve 1) its Office of Chief

Accountant database in which it tracks correspondence and consultations, 2) its Confidential Treatment Request database which tracks documents filed in paper with the Commission's Office of the Secretary, 3) the non-public EDGAR system where it uploads a) filing review correspondence including comment letters and/or correspondence with outside registrants and b) filing-specific staff memos and related documents, and 4) documents involving consultation with the Division. Because the breadth of the Subpoena Requests would require searching these internal SEC systems over an extended time period, it may be difficult to rely on search terms to significantly limit the documents that need to be reviewed. In addition, the subpoena requests would require the staff to gather and review the email files of numerous current and former SEC employees for this time period. And, once gathered and identified as responsive, any internal documents very likely would be subject to one or more privileges or protections from disclosure. As such, to require the staff to produce documents responsive to this request would impose an undue burden on the staff to produce these voluminous documents in a timely manner.

III. The Subpoenas Seek Documents Protected by Privileges.

The staff has identified numerous sources where documents subject to these subpoenas might be located. Due to the breadth of the subpoenas and the short turnaround for filing this motion, the staff has done a preliminary review of various databases that might contain these documents. Based on that review, staff represents that many of these nonpublic documents would be protected by the deliberative-process privilege and/or the work-product doctrine.

Deliberative-process privilege: The nonpublic documents sought by these requests fall under the protection of the deliberative-process privilege. That privilege is "predicated on the recognition that the quality of administrative decision-making would be seriously undermined if agencies were forced to operate in a fishbowl," and it protects information that concerns the

internal deliberative processes of a government agency. *Dow Jones & Co. v. Dep't of Justice*, 917 F.2d 571, 573 (D.C. Cir. 1990) (quotations omitted); *see also NLRB v. Sears, Roebuck & Co.*, 421 U.S. 132, 150-51 (1975) (disclosure of intra-agency deliberations and advice is injurious to federal government's decision-making functions because it tends to inhibit frank and candid discussion necessary to effective government) (citations omitted); *SEC v. Nacchio*, No. 05-cv-00480-MSK-CBS, 2009 WL 211511, at *3 (D. Col. Jan. 29, 2006) (object of deliberative-process privilege is to "enhance the quality of agency decisions by protecting" open discussion among decision makers) (citations omitted); *Abraham Fruchter & Twersky LLP v. SEC*, No. 05 Civ. 00039(HB), 2006 WL 785285, at *3 (S.D.N.Y. Mar. 29, 2006) ("the rationale behind this privilege is that officials will not communicate candidly among themselves if each remark is a potential item of discovery and front page news") (citations and internal quotation marks omitted). Specifically, the privilege may be asserted as to documents that are "predecisional" and "deliberative," including "recommendations, draft documents, proposals, suggestions, and other subjective documents which reflect the personal opinions of the writer rather than the policy of the agency." *Coastal States Gas Corp. v. Dep't of Energy*, 617 F.2d 854, 866 (D.C. Cir. 1980).

On their face, Subpoena Requests Nos. 1-6 seek documents that would expose the Commission's internal deliberations and decision-making process. For example, OCA would have to search its OCA Enforcement mailbox and Corp Fin would have to search its internal communications with its Office of Chief Counsel and Office of Chief Accountant for any documents involving consultation with the Division. It is likely that nearly every matter associated with these documents and emails is related to a pending or concluded enforcement matter. Revealing this information would have a chilling effect on the Commission's decision-

making process by inhibiting staff from sharing their candid recommendations and opinions regarding past, current and future enforcement matters. Furthermore, Corp Fin would also have to search filing-specific staff memos and related documents in the non-public EDGAR system that might be subject to this request. Here, these documents would involve the internal Corp Fin impressions and deliberations concerning accounting issues of the registrants that file reports with the Commission. Overall, the documents sought by Respondent under these Subpoena Requests contain exactly the type of deliberative and pre-decisional subject matter the deliberative-process privilege is intended to protect. *See, e.g.*, *Abraham Furchter & Twersky LLP v. SEC*, No. 05 Civ. 00039 (HB), 20163 WL 785285, at *2-3 (S.D. N.Y. March 29, 2006) (holding that the deliberative-process privilege covered drafts of a Proposed Rule, internal memoranda discussing the language of the Rule and internal emails where "the documents include[ed] the subordinates' observations and questions" which was "precisely the type of candid discussion that the deliberative process privilege is designed to shield." *See also N.H. Right to Life v. Dep't of Health and Human Servs.*, 778 F.3d 43, 53-54 (1st Cir. 2015) (deliberative-process privilege protects communications between agency employees and Office of General Counsel attorneys regarding legality of proposed replacement grant).

Work-product doctrine: The work-product doctrine also applies to the nonpublic documents requested in the Subpoena Requests. The attorney work-product doctrine protects from disclosure "documents prepared in anticipation of foreseeable litigation, even if no specific claim is contemplated." *Schiller v. NLRB*, 964 F. 2d 1205, 1208 (D.C. Cir. 1992). These protected documents can include "the files and the mental impression of an attorney . . . reflected of course, in interviews, statements, memoranda, correspondence, briefs, mental impressions, personal beliefs, and countless other tangible and intangible ways." *Hickman v. Taylor*, 329 U.S.

495, 510-11 (1947). Here, any documents related to the decision to bring an action (or not to bring an action) in a specific forum or to pursue an action at all would necessarily have been prepared in anticipation of litigation, and therefore fall squarely within the doctrine. *See SEC v. Somers*, No. 3:11-cv-00165-H, 2013 WL 4045295, at *2 (D. Kan. Aug. 8, 2013) (holding that an SEC action memorandum and associated documents "are created in anticipation of litigation, and at the very least, the attorney work product privilege protects them"); *accord* SEC v.*Merkin*, No. 11-23585-CIV, 2012 WL 2568158, at *1 (S.D. Fla. June 29, 2012); *SEC v. Nacchio*, No. 05-cv-00480-MSK-CBS, 2007 WL 219966, at *7 (D. Colo. Jan. 25, 2007) (documents including action memorandum privileged); *SEC v. Cavanaugh*, No. 98 Civ. 1818(DLC), 1998 WL 132842, at *2 (S.D.N.Y. Mar. 23, 1998) (documents privileged where prepared by attorneys determining whether to recommend enforcement action).

As stated above, both OCA and Corp Fin have documents that detail their staffs' interactions and deliberations internally and with the Division. Corp Fin's documents include filing-specific staff memos and related documents in the non-public EDGAR system which involve internal deliberations amongst the staff that often can lead to a referral to the Division. Corp Fin's documents also would include interactions and consultations between its Office of Chief Accountant and Office of Chief Counsel and the Division which could involve potential enforcement action. The OCA consultation tracking system and Enforcement Liaison mailbox would contain interactions and comments between OCA and the Division, including recommendations for enforcement action and litigation. In all of these instances, these requested documents were prepared at the request, or under the direction, of Commission legal staff where potential litigation was considered. Here, Commission attorneys in these divisions communicate amongst themselves regarding potential legal issues presented by these cases. These mental

impressions are exactly the type of subject matter that the work-product doctrine was designed to protect.

CONCLUSION

For the reasons set forth above, the Administrative Law Judge should quash Respondent's Subpoenas for Documents.

March 26, 2018

Respectfully submitted,

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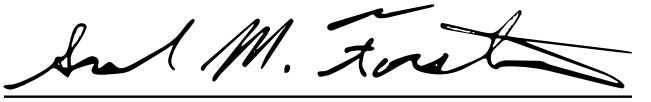

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