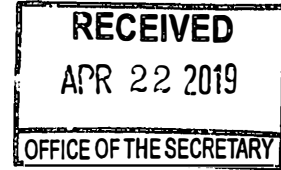


UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17950



In the Matter of

David Pruitt, CPA

Respondent.

**DIVISION OF ENFORCEMENT'S REPLY MEMORANDUM IN SUPPORT OF
MOTION TO AMEND THE ORDER INSTITUTING PROCEEDINGS**

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April 18, 2019

The Division of Enforcement (“Division”) submits this reply memorandum in support of its motion, under Rule of Practice 200(d)(2), to amend the Order Instituting Proceedings (the “OIP”) in this matter. Respondent David Pruitt’s opposition to the motion rehashes many of the same arguments the Respondent has already submitted and that have been rejected by the Court at this, the pleading stage. (*E.g.*, Feb. 12, 2019 Order Denying Respondent’s Motion for Judgment on the Pleadings.) And, those arguments that are being made anew are more hyperbole than substance and not persuasive at the pleading stage. The Court should not entertain what (as is evidenced by counsel’s Letter of April 17, 2019) amount to stall tactics.

The Court’s March 28, 2019 Order Requiring More Definite Statement, Admin. Proc. Rulings Rel. 6528, directed that, “[i]f 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.” *Id.* at 13. The Division did precisely that in filing the motion to amend the OIP on April 8, 2019. The Court further ordered, 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.” *Id.* at 16. Not surprisingly, rather than Answer the new information, Respondent has opted for more motion practice seeking to limit the consequences of his conduct as detailed clearly in the Amended OIP. The Court should grant the motion and not permit Respondent to continue to delay this proceeding. Once Pruitt answers the Amended OIP, the parties can move forward with the remaining depositions and to the hearing on this matter.

ARGUMENT

I. The proposed amendments to the OIP are within the scope of the original OIP.

The Division’s proposed amendments to the OIP concern facts and law that are plainly

within the scope of the original OIP as provided for in Rule of Practice 200(d)(2). The original OIP contained detailed factual allegations describing how Respondent's conduct constituted the knowing circumvention of L3 Technologies, Inc.'s ("L3") internal controls in violation of Section 13(b)(5) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78m(b)(5). The OIP alleges that Pruitt caused L3 improperly to recognize revenue by directing subordinates to generate invoices related to unresolved claims but withhold them from delivery to L3's customer, the U.S. Army. (OIP ¶ 2.)¹ The OIP alleges that Pruitt later took steps to mislead L3's senior corporate accounting staff and L3's auditor into believing that the invoices were delivered to the Army. The OIP also alleges that Pruitt failed to complete required estimates at completion. (OIP ¶¶ 17, 42.) The revenue associated with the invoices was improper because the criteria for recognizing revenue under Staff Accounting Bulletin 104 ("SAB 104") had not been satisfied when the invoices were generated.

The OIP alleges that Pruitt's misconduct resulted in three violations of the securities laws: (i) Pruitt caused L3's violations of Section 13(b)(2)(A) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78m(b)(2)(A), which requires issuers, such as L3, to make and keep books, records and accounts, which, in reasonable detail, accurately and fairly reflect the issuer's transactions and dispositions of assets; (ii) Pruitt violated Section 13(b)(5) of the Exchange Act, 15 U.S.C. § 78m(b)(5), which prohibits any person from knowingly circumventing or knowingly failing to implement a system of internal accounting controls or knowingly falsifying any book, record or account of an issuer; and (iii) Pruitt violated Rule 13b2-1 of the Exchange Act, 17 C.F.R. § 240.13b2-1, which prohibits any person from, directly or indirectly, falsifying or causing to be falsified any book, record or account of an issuer. (OIP ¶¶ 43-45.)

¹ Citations are to paragraphs of the original OIP, unless otherwise noted.

The Amended OIP similarly charges Pruitt with the same violations. (Amended OIP ¶¶ 49-51.) Thus, there are no new charges brought in the Amended OIP that were not previously brought in the original OIP.

As to the Section 13(b)(5) charge of knowingly circumventing L3's internal controls, the Amended OIP adds more details about the underlying factual context in which this charge was brought. (Amended OIP ¶¶ 44-47.) In addition, the Amended OIP provides a very detailed summary of each of the 25 controls the Division contends Pruitt's conduct circumvented, together with facts showing each control was violated including references to prior paragraphs in the Amended OIP. (Amended OIP ¶ 48.)

This is precisely the level of detail that Respondent sought through his motion for a more definite statement and the Court directed the Division to provide in the March 28, 2019 Order. Respondent asked for more specificity as to the internal controls charge, and asked that the Division amend the OIP. The Division has done so, and the Amended OIP describes how Pruitt's conduct circumvented each of the 25 controls. It is simply not plausible to argue that the Amended OIP includes factual allegations that are outside of the scope of the original OIP.

The Commission decision in *Matter of Carl L. Shipley*, Admin. Proc. File No. 3-3836, 1974 WL 161762 (1974), is inapposite. In *Shipley*, the Commission did not grant the Division's request to amend the OIP because the Commission lacked a statutory basis to institute the administrative proceeding, and the Division in effect wanted the Commission "to authorize the initiation of a new proceeding." *Id.* *4 (observing: "Were this an ordinary motion to amend, we would grant it without hesitation. Our general policy with respect to such motions is liberal."). In contrast, the Commission has the statutory authority to institute this proceeding, and the liberal policy of permitting amendments applies.

In summary, the Amended OIP describes how Respondent directed L3 prematurely to recognize revenue in December 2013, and took various steps to conceal his conduct or prevent it from being discovered. The Amended OIP thus contains exactly the same factual narrative contained in the original OIP, just with more details.

II. The proposed amendments to the OIP cannot surprise or prejudice Respondent.

Respondent cannot claim surprise at the additional detail provided in the Amended OIP, nor can he claim his rights are prejudiced. As the Court directed in the March 28 Order, the Amended OIP provides additional specificity as to the allegations Respondent circumvented L3's internal controls. This detail is beneficial to Respondent, and provides more than enough information for him to defend himself as to the allegations that he violates Section 13(b)(5) by circumventing L3's internal controls, including which internal controls he circumvented and facts describing his conduct that resulted in the circumvention. (Amended OIP ¶¶ 44-48.)

To the extent Respondent contends he is surprised or prejudiced because the Amended OIP identifies 25 controls, such an argument is unfounded. As noted in the Division's opening brief (at 5-6), after the Division had identified 40 controls the Division contends Respondent circumvented in the Division's February 13, 2019 More Definite Statement, the Division conferred with Respondent in a good faith effort to resolve Respondent's objection to the Division's February 13, 2019 More Definite Statement. As part of those discussions, Respondent identified 20 of the 40 controls that Respondent contends are not implicated by his conduct. Based on those discussions, in an effort to streamline the presentation of the case at trial (both the Division's case and Respondent's defense), the Division reduced the number to 25. And because the OIP is being amended prior to the hearing, the Court is in the position to mitigate any possible prejudice.

Respondent's true end game is actually to try to defeat the internal controls charge at the

pleading stage – which he has already tried unsuccessfully to do on multiple occasions. This can be seen, for instance, by his pointing to IR 4 in the parties’ discussions about narrowing the charge as a control that is not implicated by his conduct. IR 4 was the control cited in the original OIP as an example of the controls Respondent’s conduct circumvented. Having been on notice that his conduct circumvented this controls from the time the original OIP was issued, it is hard to see how he can contend that it should be excluded, other than to see it as an attempt to avoid the charge in total.

More to the point, Respondent, as the Vice President of Finance and principle financial officer of the Army Sustainment Division of L3 (“ASD”), was fully aware of L3’s internal controls environment. Indeed, if he were not, he never would have been allowed to work as L3’s ASD as its VP of Finance. And, as noted in the Division’s opening brief (at 6), Respondent distributed L3’s controls and associated process narratives to a group of L3 employees, including the President and the General Counsel of ASD, in an email sent on March 30, 2013 regarding “ASD Leadership Conference 3-28-13.” (*See* Div. Opp’n to Mot. for a More Definite Statement at 11 n.7; Amended OIP ¶ 47.)² Respondent also attached a Power Point presentation with slides under the heading “Army Sustainment Division, Finance Update, March 28-29, 2013, Dave Pruitt.” The agenda for the presentation included the topic “SOX Controls/Narratives.” One of the presentation slides indicated that: “There are 76 pages of control criteria that must be addressed in company process narratives,” including controls under the subject matters “Contract Estimating (EACs),” “Invoicing and Receivables,” “Period-End Financial Reporting,” “Revenue

² The top of each page of the relevant process narratives contains a header, in bold, reading: “**Sarbanes Oxley Section 404 Compliance.**” Section 404 of the Sarbanes-Oxley Act of 2002, P.L. 107-204, 116 Stat. 745, provides that issuers, such as L3, must include in annual reports “an internal control report,” which must state management’s responsibility for “establishing and maintaining an adequate internal control structure and procedures for financial reporting,” and “contain an assessment . . . of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.” Section 404 is codified at 15 U.S.C. § 7262.

and Cost of Sales.” Having given a presentation on internal controls, including controls that the Division has included in the Amended OIP, and circulated to others at ASD the Power Point presentation, process narratives, and internal controls, Respondent cannot possibly contend that he is surprised or prejudiced by being accused of circumventing those controls through his conduct.

Respondent argues that the amendments sought by the Division are improper under Rule 200(d)(2) because they introduce factual allegations for the first time. That is not true. Only one paragraph amplifying allegations already contained in the OIP (*i.e.*, that the invoices related to “unresolved claims” (OIP ¶ 2) has been added (Amended OIP ¶ 23). Respondent does not claim to be surprised by those allegations (nor could he, as they were facts he was personally involved in and resulted in discussions with the C-12 Contract Manager at the time, as alleged in the OIP). (OIP ¶ 24.) The Amended OIP simply provides further explanation of the facts (as the Court requested) as to how those facts circumvented the specific controls. Considering that Respondent directed the creation of sham invoices that were not delivered to the customer, and then made misrepresentations to L3 corporate and its external auditors in attempts to cover this up—all while he was not completing the estimates at completion as required—it can be no surprise that these actions circumvented 25 controls, as specifically set forth in the Amended OIP.

III. The proposed minor amendment to paragraph 21 of the original OIP is appropriate to conform the allegation to Timothy Keenan’s new version of events.

As explained in the Division’s opening brief (at 7-8), the Court should make the minor amendment to the allegation in paragraph 21 of the original OIP (as reflected in the same paragraph number of the Amended OIP) to take into account Timothy Keenan’s new version of events. The original OIP alleged, in the present tense, that Keenan “denies” giving Respondent

blanket authority to issue the invoices, but “does recall” a conversation with Respondent in which Keenan said he could invoice for option year 3. Because Keenan has now modified his recollection of events since prior incantations given to the government during the investigation, the Division submits that it is appropriate to change the tense of Keenan’s recollection from the present tense to the past tense in paragraph 21.

For the reasons previously stated in the Division’s opposition to Respondent’s motion to the Commission to amend the OIP (Div. Opp’n to Mot. to Am. the OIP at 5-8) (available at: <https://www.sec.gov/litigation/apdocuments/3-17950-event-141.pdf>), the Court should make this slight amendment to paragraph 21.

IV. The Division can seek civil penalties on the charge that Respondent violated Section 13(b)(5) of the Exchange Act.

The Division can seek civil penalties on the charge that Respondent violated Section 13(b)(5) of the Exchange Act because both the original OIP and the proposed amendments were filed within the relevant five year statute of limitations period contained in 28 U.S.C. § 2462. *See Gabelli v. SEC*, 568 U.S. 442 (2013).

The original OIP alleged that Respondent’s conduct circumvented L3’s internal controls. The Amended OIP does not alter this charge. The Amended OIP specifies the internal controls at issue and ties each control to Respondent’s conduct, which circumvented the control. It does not add new claims based on statutes Respondent had no notice of. Consequently, there is no statute of limitations issue.

Even if there were a statute of limitations issue, that should be raised as an affirmative defense in Respondent’s Answer and not as an attempted judgment on the pleadings to curtail at the outset the remedies the Division may seek. This is yet another example of Respondent trying to defeat the internal controls charge at the pleading stage rather than deal with the detailed

allegations of misconduct in the Amended OIP.

Further, whether a statute of limitations issue even exists is an issue of fact. The running of the statute was tolled on multiple occasions in this proceeding when various stays were ordered. For instance, the Court issued a stay order on November 15, 2017 to allow the Commission to consider a proposed settlement, and subsequently issued an order on December 4, 2017 ratifying the stay in light of the Commission's November 30, 2017 decision ratifying appointment of its administrative law judges. Those stay orders tolled the proceeding until the Court issued its February 14, 2018 Order Ratifying Prior Actions. Also, following the Supreme Court's decision in *Lucia v. SEC*, 138 S. Ct. 2044 (2018), the Commission stayed all administrative proceedings, including this proceeding, in Orders issued on June 21, 2018 and July 20, 2018, which tolled all deadlines until the Commission issued an Order on August 22, 2018 allowing the stay to expire effective that day. Thus, at a minimum, the proceeding was tolled for five months (November 15, 2017 to February 14, 2018, and June 21, 2018 to August 22, 2018). Consequently, Respondent's conduct in late 2013 and 2014 would nonetheless be within five years of the Amended OIP. In Commission civil enforcement cases, courts frequently stay proceedings pending the resolution of related criminal charges. When the courts do so, no existing defendant can later be heard to raise a statute of limitations defense in the SEC case. *Cf. Feld Entm't, Inc. v. ASPCA*, 873 F. Supp. 2d 288, 311 (D.D.C. 2012) (noting that courts toll "the statute of limitations against *existing* defendants during the period of time where the case was stayed") (emphasis in original).

Finally, Respondent refers Fed. R. Civ. P. 15 on amendments to pleadings in District Court actions. Rule 15(a) provides, *inter alia*, that amendments can only be made on consent or with the court's leave, and that "The court should freely give leave when justice so requires."


Rule 15(b) is not analogous because it deals with amendments of the pleadings during or after trial. Similarly, *Matter of Oppenheimer & Co.*, Admin. Proc. File No. 3-5244, 1978 WL 207543 (Oct. 19, 1987) (ALJ order), on which Respondent relies, is inapposite because, there, the Division sought to add a substantive Rule 10b-5 charge following the hearing in addition to the Rule 10b-6 charge. Finally, Rule 15(c) provides that an amendment to the original pleading relates back to the date of the original pleading when, *inter alia*, “(B) the amendment asserts a claim or defense that arose out of the conduct, transaction, or occurrence set out – or attempted to be set out – in the original pleading.” As noted above, the Amended OIP asserts the same claim that was asserted in the original OIP. But even if it were considered a new claim, it undoubtedly arose out of Respondent’s conduct as set out in the original OIP. Therefore, to the extent the Court looks to Rule 15 for guidance, its application suggests that the Court should not only freely grant leave to amend to clarify the allegations already alleged, but that the amendment should relate back to the original OIP for statute of limitations purposes. Because the original OIP was filed within five years, Respondent’s argument as to the statute of limitations for civil penalties holds no water.

CONCLUSION

For the foregoing reasons and the reasons stated in the Division's opening brief, the Division respectfully requests that the Court amend the Order Instituting Proceedings.

Dated: April 18, 2019
New York, NY

DIVISION OF ENFORCEMENT

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CERTIFICATE OF SERVICE

I hereby certify that on April 18, 2019, I caused the original and three copies of the foregoing DIVISION OF ENFORCEMENT'S REPLY MEMORANDUM IN SUPPORT OF MOTION TO AMEND THE ORDER INSTITUTING PROCEEDINGS to be filed with:

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I further certify that I caused to be served a copy of the foregoing via email upon:

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I further certify that I caused a courtesy copy of the foregoing to be provided by email to:

The Honorable James Grimes
Administrative Law Judge
Securities and Exchange Commission
100 F Street NE, Mail Stop 2582
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Paul G. Gizzi