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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 OPPOSITION TO RESPONDENT'S MOTION FOR RECONSIDERATION OF THE ORDER DENYING HIS MOTION FOR A RULING ON THE PLEADINGS

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Table of Contents

Table of Authorities

Cases

Statute and Rules

Legislative History

Respondent has moved for reconsideration of this Court's Order denying his Motion for Judgment on the Pleadings on two grounds. *First*, Respondent alleges that the Court erred as a matter of law in not dismissing the Division's claim under Section 13(b)(5) of the Securities and Exchange Act of 1934 ("Exchange Act") because the Court wrongly applied a negligence standard to that claim, rather than an intentional standard. *Second*, Respondent contends that the D.C. Circuit Court's decision in *The Robare Group, Ltd. v. SEC*, 922 F.3d 468 (D.C. Cir. 2019) had the effect of further "raising the bar" by requiring the Division to plead and prove that Respondent "subjectively intended" to knowingly circumvent L3's internal controls in violation of Section 13(b)(5) and to falsify, or cause to be falsified, L3's books and records in violation of Rule 13b2-1.

Respondent is wrong on both counts. The scienter standard applied by the Court – that liability follows when an individual purposefully undertakes actions which he or she knew or should have known circumvented a system of internal controls – is in fact a correct articulation of the legal standard and does not sound in negligence.

Further, *Robare* does not impose a higher scienter standard in this context. The D.C. Circuit, in its ruling, made clear that it was not overruling *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000), which held that willfulness requires that the person intend to engage in the act which constitutes the violation, and not more. And, in any event, the willful language applies to certain of the remedies sought by the Division and not, as Respondent alleges, to the merits of the claims themselves. Thus, for example, Rule 13b2-1 unquestionably does not require scienter and *Robare* does not change that. And the Division need not show scienter for purposes of obtaining relief under Rule of Practice 102(e).

In any event, the Court need not reach a ruling on the merits of either of Respondent's objections because those objections are moot, untimely, and were not previously raised. Respondent seeks reconsideration of a motion that was made in conjunction with a pleading that is no longer operative and has been amended. All of the arguments that Respondent now raises – including those relating to *Robare*, which was handed down on April 30, 2019 – were available to Respondent during the period where motion practice on the issues would have been timely. But they went unmade. For these additional reasons, Respondent's motion should be denied.

I. Background

On April 28, 2017, the Commission issued an Order Instituting Proceedings ("OIP") against David Pruitt ("Respondent" or "Pruitt"), alleging that Pruitt caused the public company L3 Technologies, Inc. ("L3") to improperly recognize $17.9 million in revenue in 2013 and 2014 relating to the C-12 contract between L3 and the U.S. Army. Pruitt, the OIP alleged, caused a subordinate to create invoices relating to the $17.9 million, which in turn caused L3 to recognize the revenue, without ever having reached an agreement with the Army to pay for those services and without ever delivering the vast majority of those invoices to the Army. (*See, e.g.*, OIP ¶¶ 1-2.) Pruitt's actions, as spelled out in greater detail in the OIP, caused L3's books and records to be inaccurate in violation of Exchange Act Section 13(b)(2)(A); were in knowing circumvention of L3's internal controls in violation of Exchange Act Section 13(b)(5); and caused L3's required books and records to be falsified in violation of Exchange Act Rule 13b2-1. (*See, e.g.*, OIP ¶¶ 43-45)

On December 14, 2018, Respondent moved for a ruling on the pleadings. Respondent argued, in relevant part, that because the books and records of L3 were maintained "in reasonable detail," there could be no claims under Section 13(b)(2)(A) or Rule 13b2-1

thereunder. (Mem. of Points and Authorities in Supp. of Resps. Mot. for Ruling on Pleadings ("Orig. Mot.") at 6-13.) Indeed, Respondent argued that, as it related to these claims, his state of mind was "irrelevant" and that neither the Division nor the Court is "permitted to delve into Mr. Pruitt's state of mind." (Orig. Mot. 9-10.)

With regard to the Division's Section 13(b)(5) charges, Respondent argued that (1) the Division was limited to allegations related to internal control IR4, and precluded from making allegations of internal controls not numerically enumerated in the OIP; and (2) with regard to IR4, the Division had not stated a claim because IR4 was vague and Respondent could not "knowingly" have violated an internal control that was not clear on its face. (Orig. Mot. 13-15.) Respondent's argument focused on the vagueness of the control, and not the meaning of the statutory term "knowing." Respondent did not set forth the arguments he now makes, nor did Respondent cite any caselaw on the state of mind for Section 13(b)(5) claims. (*Id.*)

On February 12, 2019, this Court issued an Order Denying Respondent's Motion for Judgment on the Pleadings ("Order"). The Court denied Respondent's attempt to find a bright line "de minimus" exception to the Section 13(b)(2)(A) or to find as a matter of law that the $17.9 million would fall below any such threshold. (Order at 3-7.)

With regard to Respondent's Section 13(b)(5) arguments, the Court again denied the motion. The Court held: "Pruitt also argues that he could not have knowingly circumvented an unclear control that does not require delivery. But liability does not depend on whether he knew the contents of a specific control; it depends on whether he consciously undertook the actions that resulted in the circumvention of L3's internal controls." (Order at 9-10 (citing *United States v. Reyes*, 577 F.3d 1069, 1080–81 (9th Cir. 2009).)

The Court further found that the OIP alleged facts sufficient to support the reasonable inference that Respondent "*actually* knew or should have known" he was in violation of L3's internal controls. (*Id.* at 10 (emphasis added).) Those allegations included that "Pruitt (1) was ASD's vice president of finance, a certified public accountant, certified management accountant, certified government financial manager, and certified defense financial manager; (2) had a motive—a bonus; (3) was told recognizing revenue without delivering invoices violated corporate policy; and (4) took action to prevent detection." (*Id.*) This is the language that Respondent now claims was erroneous as a matter of law, although Respondent leaves out the word "actually" when quoting the Court's Order.

II. The Legal Standard for Reconsideration is "Strict" and Precludes Arguments that were Previously Available But Unmade

Motions for reconsideration are generally disfavored and, in the context of the federal rules, it has been noted that the standard for granting such motion is "strict." *SEC v. Alpine Secs. Corp.*, 17-cv-4179, 2019 WL 4071783, at *1 (S.D.N.Y. Aug. 29, 2019) (quoting *Analytical Surveys, Inc. v. Tonga Partners, L.P.*, 684 F.3d 36, 52 (2d Cir. 2012)). Indeed, in connection with reconsideration of Commission Orders under SEC Rule of Practice 470, the Commission has described reconsideration as "an 'extraordinary' remedy . . . granted only in exceptional cases." *Matter of Edward M. Daspin*, Rel. No. 34-82836, 2018 WL 1234189, at *1 (Comm'n Order Mar. 8, 2018) (internal citations omitted).

Reconsideration will generally be denied unless there exists an intervening change of controlling law, a clear error of law, or necessary to "prevent manifest injustice." *Kolel Beth Yechiel Mechil of Tartikov, Inc. v. YLL Irrevocable Tr.*, 729 F.3d 99, 104 (2d Cir. 2013) (internal citation omitted). Reconsideration is "not a second opportunity to present argument upon which the Court has already ruled, nor is it a means to bring before the Court theories or arguments that

could have been advanced earlier." *Niedermeier v. Office of Baucus,* 153 F. Supp. 2d 23, 28 (D.D.C. 2001) (citation omitted). Indeed, parties cannot raise for the first time arguments on a motion for reconsideration which could have been raised in the first instance. *Chen v. Select Income REIT*, 18-cv-10418, 2019 WL 3802133, at *2 (S.D.N.Y. Aug. 13, 2019).

III. This Court Applied the Correct Scienter Standard

The Court properly applied the correct standard in reaching the conclusion that Respondent's motion for a ruling on the pleadings should be denied. Respondent makes a number of incorrect assertions about the Court's opinion in concluding that it should be reversed.

Respondent argues that the Court erred as a matter of law because Section 13(b)(5) requires scienter and, rather than applying a scienter standard, the Court applied a "'knew or should have known' standard, [which] sounds in negligence." (Respondent's Motion for Reconsideration of the Order Denying his Motion for a Ruling on the Pleadings and Memorandum of Points ("Mot.") at 2.) Respondent further argues that "[n]othing in the language of Section 13(b)(5) contemplates liability for unintentional acts that one 'should have known' would, might, or happen to violate an internal control." (Mot. at 6.)

First, Respondent misrepresents the Court's ruling. Far from holding that 13(b)(5) contemplates liability for "unintentional acts" that "would, might or happen" to violate an internal control, the Court held that there could be liability where, as has been alleged here, a Respondent "consciously undertook the actions that resulted in the circumvention of L3's internal controls," in circumstances where he, as the primary accounting officer of ASD, "actually knew or should have known" that he was violating such controls. (Order at 10.)

Second, though Respondent is correct that Section 13(b)(5) requires more than negligence, that argument is a red herring.[1] The Court applied the appropriate standard for scienter in holding that Respondent "consciously undertook the actions that resulted" in circumvention of L3's internal controls. That satisfies the statutory "knowing" standard. In first considering the prohibition against knowing falsification of accounting records and deception of auditors in the FCPA, the Senate Committee on Banking, Housing and Urban Affairs report reflects: "[T]he committee does not [] intend that the use of the term "knowingly" will provide a defense for those who shield themselves from the facts. The knowledge required is that the defendant be aware that he is committing the act which is false[,] not that he know that his conduct is illegal." S. Rep. No. 95-114, at *9 (1977). The Committee report went on to specify, "The knowledge required is that the person be aware that he is or may be making a false statement or causing corporate records to be falsified through a conscious undertaking or due to his conscious disregard for the truth." *Id.* Congress, in that context, expressly was not considering providing a defense to an individual – a corporate accounting officer and CPA no less – who shielded himself or herself from knowledge of the internal controls over financial reporting. This too was the standard imposed by the Ninth Circuit in *United States v. Reyes*, 577 F.3d 1069, 1080–81 (9th Cir. 2009) and the proper standard imposed by the Court in its February 12, 2019 Order. *See* Order at 9-10 & n.60 (citing *Reyes*); *Reyes,* 577 F.3d at 1079–1083 ("The district court correctly concluded that the congressional history confirms that Congress intended 'knowingly' only to require that the jury find that [defendant] 'was aware of that falsification and

[1] Although there is authority that Section 13(b)(5) does not impose a scienter requirement, *see SEC v. Retail Pro, Inc.*, No. 08-cv-1620, 2010 WL 1444993, at *8 (S.D. Cal. Apr. 9, 2010) (collecting cases), because the Division has alleged knowing or at least reckless misconduct, we do not address that line of cases.

did not falsify through ignorance, mistake, or accident.'") (internal citations omitted). As the Court found, the Division has alleged facts sufficient to show that Respondent knowingly circumvented the internal controls. (Order at 9-10.)

And, in any event, the "actually knew or should have known" language applied by the Court – which the Court applied not to the conscious undertaking of Respondent's actions alleged by the Division, but rather to Respondent's awareness of the provisions of the internal controls that he was circumventing – sounds not in negligence, but in recklessness. *See, e.g., In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 76 (2d Cir. 2011) (citing *Novak v Kasaks*, 216 F.3d 300, 308 (2d Cir. 2000)) (in the context of fraud violations, "[w]here the complaint alleges that defendants knew facts or had access to non-public information contradicting their public statements, recklessness is adequately pled for defendants *who knew or should have known* they were misrepresenting material facts with respect to the corporate business") (emphasis added); *Retail Pro, Inc.*, 2010 WL 1444993, at *9 (concluding that signing a management representation letter with a "knowing or at least reckless 'intent to deceive' the auditors" constituted a violation of Section 13(b)(5)) (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976)). And, courts have held that recklessness is sufficient to satisfy scienter under the securities laws. *See, e.g., Novak*, 216 F.3d at 308, 311; *but see SEC v. Stanard*, No. 06 CIV 7736 (GEL), 2009 WL 196023, at *30 (S.D.N.Y. Jan. 27, 2009) (holding that conduct had to be knowing, not reckless, but not ruling that defendant had to know of the specific internal controls at issue). That the Court was *not* setting forth a negligence standard is further made clear by the Court's citation to *SEC v. Egan*, 994 F. Supp. 2d 558, 565-55 (S.D.N.Y. 2014) in footnote 61, which discusses the pleading standards for recklessness in the fraud context.

Respondent argues for a different standard requiring that "the Division must plead and prove that Mr. Pruitt was (1) *aware* of the internal controls he was allegedly evading; (2) *aware* of the purposeful and evasive 'conduct' he was allegedly engaged in; and (3) *aware* that the consequences of that purposeful and evasive conduct would be the circumvention of the internal controls at issue." (Mot. at 7 (emphasis in original).) But, no case cited by Respondent imposes that standard. Thus, for example, the *Stanard* Court found, after a bench trial, that the defendant violated Section 13(b)(5) because he "knew that [a second defendant] was involved in a fraudulent scheme intended to fool [the company's] auditors. Because the central purpose of that fraud was the improper accounting associated with the Inter–Ocean Transaction (which necessitated [the] creation of the improper and inaccurate 2001 and 2002 [company] books and records), the Court finds that Stanard violated Exchange Act Section 13(b)(5)." 2009 WL 196023, at *30. Contrary to Respondent's assertion, the *Stanard* court did not impose a requirement or find that the defendant knew of the specific internal controls that were violated by lying to the auditors. 2009 WL 196023, at *30.[2] *SEC v. Falstaff Brewing Corp.*, 629 F.2d 62, 77 (D.C. Cir. 1980), and *Svalberg v. SEC*, 876 F.2d 181, 184 (D.C. Cir. 1989), which Respondent

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[2] *SEC v. China Northeast Petroleum Holdings, Ltd.*, 27 F. Supp. 3d 379, at *394 (S.D.N.Y. Mar. 27, 2014) (finding with regard to scienter on Section 13(b)(5) charges, the "'securities laws do not require that a defendant know the precise accounting treatment that would have been applied before [he] can have the requisite scienter; the SEC need only demonstrate that [a defendant] knew of facts that contradicted the substance of the reported accounting.'") (quoting *SEC v. Espuelas*, 767 F. Supp. 2d 467, 476 (S.D.N.Y. 2011)); *Retail Pro, Inc.*, 2010 WL 1444993, at *3 ("Evidence showing that a person misled company auditors can support a claim that the person knowing circumvented a company's system of internal accounting controls" but not referencing specific knowledge of internal controls, and collecting cases that show the same); *SEC v. Lucent Technologies, Inc.*, 04-cv-2315, 2005 WL 1683741 (D.N.J. July 18, 2005) (allegation that defendant lied to the chief accountant was sufficient to support Section 13(b)(5) claim, without reference to defendant's knowledge of a specific internal control).

also cites (and which are *not* cases brought under Section 13(b)(5)) stand for the proposition that a defendant must know of the act that he is undertaking "and the consequences of those actions."

But here, the Division has made such allegations. The Division has alleged that Respondent knowingly instructed subordinates to create invoices; that he understood the consequence of that action would be the recognition of revenue for L3; that he knowingly did so without approval from L3 (the corporate parent company); that he provided instructions not to submit the invoices through WAWF and to withhold delivery of most of the invoices from the Army (Amended OIP at ¶¶ 1-2; 20-28); that he took actions to hide his conduct from auditors and other management (*Id.* at ¶¶ 32-39); that he was motivated to recognize the revenue in order to meet his bonus; (*Id.* at ¶ 9); that he was a Vice President of Finance, a certified public accountant, a certified management accountant, a certified government financial manager and a certified defense financial manager (*Id.* ¶ 4); that he knew of L3's internal controls and bore sufficient responsibility to circulate them to ASD's president, general counsel and C-12 Contract Manager in connection with a leadership conference at which he presented (*Id.* at ¶ 47). Pruitt acted with sufficient knowledge of the act he was undertaking and its consequences to satisfy the standard in the cases set forth by Respondent. The allegations are far above pleading negligence.

Moreover, the parade of horribles that Respondent appears to argue would flow from the Court's (correct) legal construction is misplaced. Respondent argues that the Court's interpretation would "render the 'knowingly' standard meaningless" and "impose liability in situations where the actor was entirely unaware of the existence of a control." (Mot. at 8.) But that, again, is not a fair reading of the Court's opinion. Rather the Court's holding would "impose liability" where an actor knowingly engaged in misconduct, as a matter of corporate responsibility actually knew of, or otherwise should have been (or had an obligation to be) aware

of, the controls at issue, but claims not to have been so aware. And, in any event, the allegations in the OIP are that Respondent was (and should have been) aware of the internal controls. (Amended OIP ¶ 4, 47.)[3]

Finally, Respondent should be precluded from now making this argument. Respondent's motion for judgment on the pleadings focused on the purported vagueness of the internal control and argued, with regard to scienter, that Respondent could not have knowingly violated a control that was vague. But Respondent's argument now is different. He now centers on the overall scienter standard and claims that the Division has otherwise failed to meet that pleading standard. Reconsideration is not the appropriate mechanism for raising arguments that could have been, but were not raised in an initial motion. *Chen*, 2019 WL 3802133, at *2. In any event, the Division has adequately alleged Respondent's state of mind.

IV. *Robare* Does Not Create A New Standard for Willfulness and is Not Dispositive Here

Pruitt also argues that the Section 13(b)(5) and Rule 13b2-1 charges should be dismissed because, under *The Robare Grp., Ltd. et al. v. SEC*, 922 F.3d 468 (D.C. Cir. 2019), the Division would have to prove that his conduct was more than merely negligent to bar him from practicing before the Commission under Rule 102(e), which authorizes the Commission to bar persons who have "willfully violated" any provision of the securities laws.[4] (Mot. 10-11.) As discussed

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[3] Separately, Respondent states in footnote 12 of his motion that "[h]ere, the alleged violations of Section 13(b)(5) and Rule 13b2-1 both require proof of scienter so negligent conduct is never sufficient to set forth a violation." Respondent is incorrect. Rule 13b2–1 does not impose a scienter requirement. *See SEC v. McNulty,* 137 F.3d 732, 741 (2d Cir.1998).

[4] Respondent's argument now stands in stark contrast to the argument Respondent made in his motion for a ruling on the pleadings, where he argued that, as it related to Rule 13b2-1 (and Exchange Act Section 13(b)(2)(a)), his state of mind was "irrelevant" and that the Division and the Court were "not permitted to delve into Mr. Pruitt's state of mind." (Orig. Mot. at 9-10.) Because, as discussed below, *Robare* by its own terms did not overrule *Wonsover v. SEC*, 205

above, however, the Division alleges that Pruitt's conduct in this case was not merely negligent, but knowing and intentional, or at least reckless. Therefore, even if Pruitt were correct that *Robare* changed the showing required to establish that a person "willfully violate[d]" the securities laws under Rule 102(e) and similar provisions, a bar would still be warranted. *See Robare*, 922 F.3d at 479-80 (requiring a showing of scienter to establish that a person "willfully" omitted material information from a Form ADV in violation of Section 207 of the Investment Advisers Act of 1940). For that reason, the Court need not address Pruitt's contention.

In any event, Pruitt misreads *Robare*. *Robare* did not purport to overrule or otherwise limit the D.C. Circuit's earlier decision in *Wonsover v. SEC*, 205 F.3d 408 (D.C. Cir. 2000). *Wonsover* construed the term "willfully" for purposes of Exchange Act Section 15(b)(4), which, like Rule 102(e), authorizes the Commission to impose certain remedies on persons who "willfully violated" any provision of the securities laws. *Wonsover* explained – and *Robare* reiterated – that "'[i]t has been uniformly held that 'willfully' in this context means intentionally committing the act which constitutes the violation.'" *Robare*, 922 F.3d at 479 (quoting *Wonsover*, 205 F.3d at 414).[5] Applying this standard, courts have found violations of non-scienter-based provisions of the securities laws to be willful where the act (or failure to act) that resulted in liability was not inadvertent or accidental, with no showing of scienter or recklessness required.[6]

F.3d 408 (D.C. Cir. 2000) or create new law, it is hard to see how Respondent can credibly make such a legal about-face.

[5] Other courts of appeals have articulated the same standard. *See Arthur Lipper Corp. v. SEC*, 547 F.2d 171, 180 (2d Cir. 1976) ("All that is required is proof that the [person] acted intentionally in the sense that he was aware of what he was doing.") (quotation omitted); *Nees v. SEC*, 414 F.2d 211, 221 (9th Cir. 1969) ("[W]illful" in this context "means only that the act was a conscious, intentional action.").

[6] *See, e.g.*, *Steadman v. SEC*, 603 F.2d 1126, 1135 (5th Cir. 1979) (affirming imposition of relief for willful violation of Section 15(a) of the Investment Company Act); *Stead v. SEC*, 444

Robare's application of the *Wonsover* standard to a statute requiring willfulness as an element of the offense is thus irrelevant to determining whether a person has, for purposes of Exchange Act Section 15(b) or Rule 102(e), willfully violated a provision (such as Rule 13b2-1) that requires no culpable mental state. In that context, willfulness turns solely on whether the act resulting in liability was voluntary rather than inadvertent or accidental. This result likewise flows from *Wonsover*, which requires "no more than that the person charged with the duty knows what he is doing," and does not also require that the person know he is violating the law. *Wonsover*, 205 F.3d at 414.

Finally, even if Pruitt's reading of *Robare* were correct, it would not justify dismissing any of the charges. None of the underlying violations alleged by the Division in this case requires a showing of willfulness, and such a showing is a prerequisite to only one of several remedies the Division seeks.

V. Respondent's Motion Should Additionally Be Denied as Moot and Untimely

The Order of which Respondent now seeks reconsideration was an Order Denying Respondent's motion for judgment on the pleadings – the operative pleading being the Division's April 28, 2017 Order Instituting Proceedings. Subsequent to that date, the Court granted the Division's Motion to Amend the OIP on April 26, 2019, and Respondent filed an Answer on April 29, 2019. Thus, Respondent is seeking reconsideration of the Court's Order

F.2d 713, 716-17 (10th Cir. 1971) (affirming imposition of relief for willful violation of Section 5 of the Securities Act and Section 17(a) of the Exchange Act); *Quinn & Co. v. SEC*, 452 F.2d 943, 946-47 (10th Cir. 1971) (affirming imposition of relief for willful violation of Section 5 of the Securities Act); *Nees*, 414 F.2d at 221 (9th Cir. 1969) (same); *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965) (same).

denying Respondent's motion for a ruling as a matter of law on pleadings that are no longer operative. For that reason alone, their motion should be denied as moot.[7]

But, Respondent not only failed to file a motion for a ruling on the pleadings relative to the Amended OIP and Answer, which under SEC Rule of Practice 250(a) had to be filed within 14 days of his April 29, 2019 Answer: Robare *came down the next day.* Had Respondent made such a motion (which would have been due on May 13, 2019), he would have had the timely opportunity to raise his arguments based on *Robare*. Respondent had that opportunity, but he did not make any such motion, and cannot do so five months later on the eve of the hearing. For this additional reason, Respondent's motion should be denied.

[7] Assuming for the sake of argument that the SEC Rules of Practice allow for motions for reconsideration (an issue not explicitly addressed in the rules), there is no good reason to believe that reconsideration of an order should be allowed *at any time* during the proceeding. In federal court, motions for reconsideration under Federal Rule of Civil Procedure 59(e) have a deadline of twenty-eight days following the issuance of the pertinent order. (*See also* S.D.N.Y. and E.D.N.Y. Loc. R. Civ. P. 6.3 (setting 14 days for other reconsideration motions); SEC Rule of Practice 470 (setting 10 days).) It is hard to imagine the standard under which a motion seeking reconsideration of an order that is filed six months and twenty-five days after the operative order is timely.

VI. Conclusion

For the reasons stated above, the Court should deny Respondent's Motion for Reconsideration of the Court's Order Denying his Motion for a Ruling on the Pleadings. Likewise, there is no reason for the Court to correct the legal standard in its February 12, 2019 Order, as Respondent contends.

Dated: September 6, 2019
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