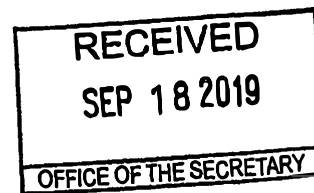
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17950

In the Matter of,
David Pruitt, CPA
Respondent.



RESPONDENT DAVID PRUITT'S REPLY MEMORANDUM IN SUPPORT OF MOTION FOR RECONSIDERATION OF THE ORDER DENYING HIS MOTION FOR A RULING ON THE PLEADINGS

Respondent David N. Pruitt ("Mr. Pruitt") respectfully submits this reply memorandum in further support of his Motion for Reconsideration of the Order Denying His Motion for a Ruling on the Pleadings dated August 23, 2019 ("Motion").

I.e RESPONDENT'S MOTION IS PROPERLY BEFORE THE COURTe

As an initial matter, Respondent reiterates that his Motion is properly before the Courte where a legal standard is in error and the hearing will shortly commence. *See Brodie v. Worthington*, 841 F. Supp. 2d 91, 94 (D.D.C. 2012). Reconsideration is appropriate here where there has been an intervening change in law due to the *Robare* decision and to prevent the injustice that would result from Respondent being subjected to a legal standard involving a lesser mental state than the one required by the statute he is charged with violating. The Division should have the same interest as Respondent in seeing that the correct legal standards are applied at the upcoming hearing.

Moreover, if the legal standard is in error or at a minimum requires clarification, it is not relevant which pleading was originally operative and later amended. In any event, Respondent's Motion addresses the internal controls allegations in the Amended OIP, and the Section 13(b)(5) charge has been present since the day this proceeding began. Although Respondent did in fact address the meaning of "knowing circumvention" in his Motion for Ruling on the Pleadings, he could not be expected to raise the arguments that are raised in this Motion which are in response to the standard articulated by the Court. This Motion is properly before the Court so the error can be corrected, and the pleadings can be dismissed.

II. SECTION 13(b)(5) REQUIRES KNOWLEDGE, NOT RECKLESSNESS OR NEGLIGENCE

Section 13(b)(5), as opposed to other provisions of Section 13(b), requires knowledge.[1] *SEC v. China Ne. Petroleum Holdings Ltd.*, 27 F. Supp. 3d 379, 393 (S.D.N.Y. 2014) ("Section 13(b)(5) requires plaintiffs to plead that an individual acted with knowledge in order to hold said person liable."). Respondent does not dispute, and in fact agrees, that Section 13(b)(5) requires proof that Respondent "actually knew" he was violating L3's internal controls. Actual knowledge in such a situation requires knowledge of the controls at issue and acting with the knowledge and intent that the alleged conduct would lead to a circumvention of those controls. This is precisely what Respondent has argued in his moving brief. Whether Respondent "knew or should have known" he was violating L3's internal controls is a negligence standard, permitting liability that is contrary to the plain language of Section 13(b)(5).

The D.C. Circuit and the Commission itself have referred to the "knew or should have known" language as "classic negligence language" when interpreting the language of Section 21C of the Exchange Act. *KPMG, LLP v. SEC*, 289 F.3d 109, 120 (D.C. Cir. 2002) ("[T]he Commission was virtually compelled by Congress' choice of language in enacting Section 21C to interpret the phrase 'an act or omission the person *knew or should have known* would contribute to such violation' as setting a negligence standard."). The Division provides no basis for concluding otherwise.

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[1] The Division cites to *SEC v. Retail Pro, Inc.*, No. 08cv1620-WQH-RBB, 2010 WL 1444993 (S.D. Cal. Apr. 9, 2010), for the proposition that there is authority that Section 13(b)(5) does not impose a scienter requirement, though the Division does not address that authority because it claims it has alleged knowing or at least reckless misconduct. *Retail Pro* is not persuasive authority on this issue as it cites to some cases that address Section 13(b) generally, as opposed to the knowledge requirements of Section 13(b)(5) specifically. The plain language of Section 13(b)(5) indicates that it has a scienter requirement, even if other provisions in Section 13(b) do not. *See SEC v. Kelly*, 765 F. Supp. 2d 301, 323 (S.D.N.Y. 2011) ("To establish a claim under Section 13(b)(5), there must be a showing that the Defendants acted with knowledge.").

Although the Court's recitation of the knowledge standard for Section 13(b)(5) in the Order[2] includes the words "actually knew" alongside the words "should have known," this stille sets forth an incorrect standard. First, this language includes both intent and a negligence standard. "Intent and negligence are regarded as mutually exclusive grounds for liability." *Robare Grp., Ltd. v. SEC*, 922 F.3d 468, 479 (D.C. Cir. 2019) (quoting *Harris v. U.S. Dep't of Veterans Affairs*, 776 F.3d 907, 916 (D.C. Cir. 2015)). An act may be intentional or negligent, "but it cannot be both." *Id.* In any event, negligence does not suffice. Second, the Court held that certain allegations in the OIP "support the reasonable inference that Pruitt *knew* or should have known he was allegedly circumventing L3's internal controls."[3] This portion of the Order does not include the word "actual" and is the exact same standard the D.C. Circuit found to be negligence. *See KPMG, LLP*, 289 F.3d at 120. Third, the Court held that "knowingly" only requires an actor to consciously undertake actions that result in a controls circumvention. This language falls far short of what the term "knowingly" requires under Section 13(b)(5) and is inconsistent with the plain language which requires scienter.[4]

Despite case law to the contrary, the Division argues that reckless conduct is sufficient to establish a violation and equates the "knew or should have known" negligence standard withe recklessness.[5] Even if this contention was supported by the law, the language of Section

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[2] Order Denying Respondent's Motion for Judgment on the Pleadings, *In the Matter of David Pruitt, CPA*, Admin. Proc. File No. 3-17950 (Feb. 12, 2019).
[3] Order at 10 (emphasis added).
[4] As Respondent has argued in his moving brief, in the context of a Section 13(b)(5) violation, 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.
[5] Courts have interpreted reckless conduct to go far beyond the "knew or should have known" standard the Division proffers. Even if this were applicable to Section 13(b)(5), recklessness has been defined as "an act so highly unreasonable and such an extreme departure from the standard

13(b)(5) does not permit reckless conduct to suffice. The *Stanard* court made clear that the plain language of Section 13(b)(5) is knowing and not recklessness and the Division cites no contrary precedent on point. The Division contends that because the court in *Stanard* did not rule that the defendant had to know of the specific internal controls at issue there is no such requirement. The defendant in *Stanard* however, was charged with violating Section 13(b)(5) for "knowingly failing to implement a *system* of internal accounting controls" and "knowingly falsifying, directly or indirectly, or causing to be falsified, books, records and accounts." 2009 WL 196023, at *30 (emphasis added). Knowing circumvention of specific internal controls was not apparently at issue as it is here nor did the court specifically address the issue.

The Division's claim that "courts have held that recklessness"[6] can meet certain scientere standards in the securities laws does not salvage this argument since the securities laws do not have a "one size fits all" approach to scienter. *See, e.g.*, Exchange Act Section 10(b) (requiring scienter); Securities Act of 1933 Section 17(a)(1) (requiring proof of scienter); Securities Act of 1933 Section 17(a)(2) & (3) (negligent conduct sufficient to establish a violation).[7]e In addition, e when Congress intends for the standard to be recklessness it has specifically said so. The Dodd -

of ordinary care as to present a danger of misleading the plaintiff to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it." *Ottmann v. Hanger Orthopedic Grp., Inc.*, 353 F.3d 338, 343 (4th Cir. 2003) (collecting cases); *see also Menaldi v. Och-Ziff Capital Mgmt. Grp. LLC*, 277 F. Supp. 3d 500, 516 (S.D.N.Y. 2017) (quoting *In re Eletrobras Sec. Litig.*, 245 F. Supp. 3d 450, 467 (S.D.N.Y. 2017)) ("[R]eckless conduct is, at the least, conduct which is highly unreasonable and which represents an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it."). In any event, the OIP also fails to allege facts that meet the true definition of recklessness as set forth in the case law cited herein and would be subject to dismissal on that basis as well.

[6] Opposition at 7.

[7] *Aaron v. SEC*, 446 U.S. 680, 696-97 (1980) (holding that the language of § 17(a) requires scienteraunder § 17(a)(1), but not under § 17(a)(2) or § 17(a)(3)); *Pagel Inc. v. SEC*, 803 F.2d 942, 946 (8th Cir. 1986) (same).

Frank amendments added recklessness as the standard for establishing aiding and abetting liability under Section 20(e) of the Exchange Act.[8] There is no reason to believe that Congresse intended for anything other than knowing conduct to violate Section 13(b)(5).[9]e

The Division's interpretation of Section 13(b)(5) would render the word knowingly meaningless, and subject Respondent to liability for what the Division posits Respondent should have known, and not what he actually knew or did.

III. *ROBARE* CREATED A NEW STANDARD FOR WILLFULNESS THAT THE DIVISION FAILS TO MEET

The Division argues that *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). But the *Robare* Court specifically stated that it will "assume (without deciding) that the *Wonsover* standard governs" but then went on to render a new and higher threshold for the term "willfully." *Robare*, 922 F.3d at 479. At a minimum, these two cases are inconsistent and the *Robare* court did not limit its analysis of what willfulness means to the statutory provision at issue. Nothing in the opinion states that "willfully," as the court defined it only applies to Section 207 of thee Investment Advisers Act and there is nothing in the court's opinion that suggests it intended to create two competing definitions of the same term. *Robare*'s definition of willfully applies to other provisions of the securities laws including the use of the term at issue here.

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[8] *See* 15 U.S.C. § 78t(e); Dodd-Frank Wall Street Reform and Consumer Protection Act, PLe 111-203, July 21, 2010, 124 Stat 1376 (Sec. 929O. Aiding and Abetting Standard of Knowledgee Satisfied by Recklessness).e

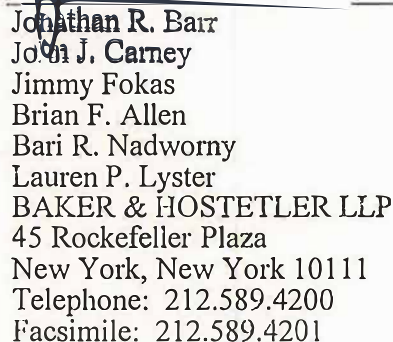
[9] As the Division has been wont to do in these proceedings, it introduces yet another new theory of liability that has no factual basis in the OIP. Specifically, the Division, citing to legislative history, argues that "knowingly" does not protect one who shields him or herself from facts.e There is not a single allegation in the OIP that claims Respondent shielded himself from the facts. Even if there was, this does not relieve the Division of its obligation to prove that Mr. Pruitt acted knowingly as that term is defined.

In order to establish the "willfulness" of the alleged violations of Section 13(b)(5) and Rule 13b2-1, the Division must show that Mr. Pruitt *subjectively intended* to engage in knowing circumvention of L3's internal controls and *subjectively intended* to falsify its books and records. *See id.* (citing *Wonsover* 205 F.3d at 413-15). The OIP fails to allege either and the willfulness portions of each charge fail as a matter of law and must be dismissed.

CONCLUSION

For the reasons set forth herein, the Court should grant Mr. Pruitt's motion for reconsideration and dismiss the Section 13(b)(5) and Rule 13b2-1 charges, or, at a minimum, correct the legal standard necessary for establishing a "knowing circumvention" of internal controls.

Dated: September 11, 2019
New York, New York

By: 

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CERTIFICATE OF SERVICE

I, Bari R. Nadworny, an associate at the law firm of Baker & Hostetler LLP located at 45 Rockefeller Plaza, New York, New York 10111, hereby certify that on the 11th day of September, 2019, I caused to be served a true copy of Respondent David Pruitt's Reply Memorandum in Support of Motion for Reconsideration of the Order Denying His Motion for a Ruling on the Pleadings as well as Respondent David Pruitt's Reply Memorandum in Support of Motion to Preclude the Division of Enforcement from Objecting to Respondent's Exhibit List via electronic mail upon the following parties and other persons entitled to notice.

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