UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17950

In the Matter of,

David Pruitt, CPA

Respondent.

REPLY MEMORANDUM IN FURTHER SUPPORT OF RESPONDENT DAVID PRUITT'S MOTION FOR A RULING ON THE PLEADINGS

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Pursuant to Rule 250(a) of the Securities and Exchange Commission's ("SEC" or the "Commission") Rules of Practice, Respondent David N. Pruitt ("Mr. Pruitt"), through his undersigned counsel, respectfully submits this reply memorandum in further support of his Motion for a Ruling on the Pleadings (the "Motion").

PRELIMINARY STATEMENT

The Division's Opposition to Respondent's Motion for a Ruling on the Pleadings (the "Opposition") makes clear that the Staff did not consider the law prior to commencing this proceeding. Instead of focusing on the narrow legal issues relevant to this Motion, the Division resorts to arguing unproven facts irrelevant to the accuracy of L3 Technologies, Inc.'s ("L3") books and records and the lack of an internal control requiring invoice delivery. Even after three years of investigation, hundreds of thousands of documents, and dozens of witnesses the Division continues to struggle with the undeniable fact that the alleged 14/100th of one percent (.0014) accounting variation at issue cannot constitute a violation under the books and records provisions. The Division's regurgitation of the facts alleged, many of which are simply not accurate, does nothing to cure the *legal* deficiencies of the books and records and internal controls charges it has leveled. That the Division spends much of its Opposition arguing the facts rather than the law is a clear admission that the law does not support the violations alleged in the Order Instituting Proceedings ("OIP"). It would be fundamentally unfair to require Mr. Pruitt to withstand a full hearing on issues that could never legally amount to a violation. Mr. Pruitt is entitled to immediate relief and the dismissal of the OIP.

The Division's attempts to disparage Mr. Pruitt are nothing more than a distraction from the fact that the OIP fails as a matter of law. Having charged Mr. Pruitt with the secondary violation of "causing" L3's books and records violations, the Division has failed to allege the primary violation that L3's books and records were inaccurate. L3's books and records were

maintained "in reasonable detail" as required by law and the Opposition's heated factual recitation does nothing to cure this defect in its OIP. The Division also ignores and mischaracterizes the intent, supported by the legislative history, of the statutory provisions under which it brings its charges. The alleged misconduct is not the type of conduct Congress sought to address through the enactment of Sections 13(b)(2)(A) and 13(b)(5) of the Exchange Act and Rule 13b2-1 thereunder. Similarly, the legislative history makes clear that the words "in reasonable detail" in Section 13(b)(2)(A) were not meaningless additions but were added to prevent the Division from bringing the exact type of *de minimis* charges it sets forth in the OIP.

The standard for maintaining books and records is not one of perfection or absolute exactitude. The reasonableness of Mr. Pruitt's alleged conduct or his purported mental state is simply irrelevant to whether the books and records were maintained with the *legally* required reasonable detail. Because the books and records were maintained as required by the statute, and because 14/100th of one percent ($17.9 million out of $12.622 billion) cannot be described as anything other than *de minimis*, the Division's books and records charges fail as a matter of law and the Court should provide Mr. Pruitt with the relief of dismissal.

More troubling is the Division's continued failure, despite the Court's order, to identify the specific internal control that applied and was alleged to have been circumvented. No amount of verbal gymnastics by the Division can change the fact that L3 did not have an internal control that required delivery of invoices to a customer nor did it have an internal control that required delivery of invoices to a customer before revenue could be recognized. The Division's tortured reading of the language of L3's internal control IR 4 contradicts the plain language of the control which concerns the posting of invoices and not their delivery to a customer. Mr. Pruitt cannot

circumvent an internal control that did not exist and this charge must be dismissed as a matter of law. The Court should grant the instant Motion.

ARGUMENT

I. L3'S BOOKS AND RECORDS WERE MAINTAINED IN REASONABLE DETAIL

A. The Reasonableness of Mr. Pruitt's Alleged Conduct and His Alleged Mental State Are Not Relevant to the "Reasonable Detail" Analysis

Congress did not draft the books and records provisions to *punish* companies whose books and records are maintained in the required reasonable detail.[1] The plain meaning of the statute as well as the legislative history does not change the incontrovertible point that reasonable detail is met where the alleged inaccuracy is miniscule and as a matter of law a deviation amounting to .0014 cannot render the books and records of L3 inaccurate. The Division argues that a "prudent person" test is the appropriate test for "reasonable detail" based on the legislative history and the language in Section 13(b)(7). But that standard is applied to the issuer and the reasonableness of the issuer's books and records, not an individual's conduct. The Division cannot place the cart before the horse by focusing on Mr. Pruitt's conduct before establishing that the books and records themselves were inaccurate in the first place.[2] Having been charged with the *secondary violation* for "causing" L3's books and records violations, it is beyond dispute that this requires establishing the primary violation that L3's books and records were in fact inaccurate and not maintained in reasonable detail. The Division and the OIP it drafted ignores this critical requirement.

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[1] The amendment from the House of Representatives that added the "in reasonable detail" language to modify "accurately" in Section 13(b)(2)(A) of the Exchange Act "makes clear that the issuer's records should reflect transactions in conformity with accepted methods of recording economic events and effectively prevent off-the-books slush funds and payments of bribes." H.R. Rep. No. 94-831, 95th Cong., 1st Sess. at 10 (1977).

[2] Section 13(b)(7) specifically states that the term "reasonable detail" means "such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs."

Under Section 13(b)(2)(A) it is the issuer's obligation to make and keep its books and records in reasonable detail. *See, e.g.*, *SEC v. Das*, 723 F.3d 943, 954 (8th Cir. 2013); *In re Key Energy Servs., Inc. Sec. Litig.*, 166 F. Supp. 3d 822, 843 (S.D. Tex. 2016). The SEC's own guidance states that the "'in reasonable detail' qualification was adopted by Congress 'in light of the concern that such a standard, if unqualified, might connote a degree of exactitude and precision which is unrealistic.'" U.S. Dep't of Justice & U.S. Sec. & Exch. Comm'n, *A Resource Guide to the U.S. Foreign Corrupt Practices Act*, at 39 (2012) (quoting H.R. Rep. No. 94-831, at 10), *available at* https://www.sec.gov/spotlight/fcpa/fcpa-resource-guide.pdf. Determinations of what constitutes "reasonable detail" "are based not on a 'materiality' analysis but on the level of detail and degree of assurance that would satisfy prudent officials in the conduct of their own affairs." SEC Staff Accounting Bulletin No. 99, Release No. SAB 99, 17 C.F.R. Part 211 (Aug. 12, 1999) (citing 15 U.S.C. § 78m(b)(7)).[3] Even if the "prudent person" standard is the correct one, the question here is not whether Mr. Pruitt's alleged conduct was reasonable or prudent as it relates to the generation of the invoices at issue. The threshold question, entirely ignored by the Division, is one of "detail and degree" relating solely to the accuracy of the books and records as maintained by the issuer—L3. There cannot be a secondary violation because L3's books and records were kept in reasonable detail and in accordance with the statute.

[3] SAB 99 further notes that in "the conference committee report regarding the 1988 amendments to the FCPA, the committee stated, 'The conference committee adopted the prudent man qualification in order to clarify that the current standard does not connote an unrealistic degree of exactitude or precision. The concept of reasonableness of necessity contemplates the weighing of a number of relevant factors, including the costs of compliance.'" *Id.* n.33 (quoting Cong. Rec. H2116 (daily ed. Apr. 20, 1988)); *see also* H.R. Conf. Rep. No. 100-576, 100th Cong., 2nd Sess. at 917 (1988).

The Division cannot credibly argue that the purported inaccuracy caused by the invoices (what amounts to 14/100th of one percent of L3's total revenue in 2013)[4] led to financial statements that were not kept in reasonable detail. Unable to contradict the *de minimis* nature of the alleged improper revenue, the Division instead attempts to distract the Court by relaying the spurious factual allegations of the OIP. These factual arguments are entirely irrelevant to whether L3's books and records were kept in reasonable detail and do not cure the legal deficiencies of the OIP.[5]

The Division itself cites to legislative history that supports the common sense interpretation that Congress did not pass a law that required perfection. The standard in Section 13(b)(2)(A) was not meant to "connote an unrealistic degree of exactitude or precision." H.R. Conf. Rep. No. 100-576, at 917. It defies common sense to imply, as the Division has, that the size of L3 and the substantial nature of its reported revenue in 2013—$12.622 billion—is not relevant to determining whether L3's books and records were maintained in reasonable detail. The negligible amount of revenue at issue cannot have rendered the books and records of a company the size of L3 to be inaccurate pursuant to the standard set forth in Section 13(b)(2)(A). The Division makes much of Mr. Pruitt's citation to the statements of then-SEC Chairman

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[4] *See* Affidavit of Margaret Hirce ("Hirce Aff.") Ex. B.

[5] The Division continues to use misleading phrases such as "sham invoices" or "fictitious invoices" to describe the invoices generated in December 2013. Apart from being inaccurate, doing so indicates the Division's fundamental misunderstanding of its own case. As has already been pointed out, the OIP is silent as to how the content of these invoices were fictitious or a sham. *See* Reply Memorandum in Further Support of Respondent David Pruitt's Motion for a More Definite Statement, *IMO David Pruitt, CPA*, Admin. Proc. File No. 3-17950, at 4 n.3 (June 16, 2017). The Division does not and cannot dispute that the work underlying the invoices was legitimate, actually performed for the U.S. Army, and pursuant to a detailed arm's length contract. *See* OIP ¶ 10 ("By mid-November 2013, the C-12 Contract Manager identified approximately $50.6 million in work performed by ASD under the contract that was not billed to the Army."). There is nothing fictitious about the invoices. The Division's mischaracterization is again an attempt to turn these facts into something they are not.

Harold M. Williams. The additional words that the Division focuses on[6] do not however, change the analysis. *See* 17 C.F.R. Part 241 at 11546 (1981). Simply stated, the Commission's own guidance makes it clear that the level of perfection advocated for by the Division is not required or mandated by the books and records provisions. As Chairman Williams stated:

> I turn first to the question of whether the Act's text of purpose mandates that business records and controls conform to a standard of absolute exactitude or that a company's control system meet some absolute ideal. The answer is "no." Both of the Act's accounting provisions, it should be noted, are modified by the key term "reasonable."

Id. While the Division might prefer an unbounded interpretation of the statute, it is clear that perfection and unrealistic exactitude is simply not the standard Congress intended. To find otherwise would be contrary to this intent and effectively make meaningless the words "in reasonable detail," which were purposefully added to the statute. *See* S. 3133 and S. 3134, 94th Cong. (1976); H.R. Rep. No. 94-831, at 10. To the extent there is any lack of clarity in the meaning of the words "in reasonable detail," this Court is in the best position to interpret the phrase as it relates to L3's books and records and the indisputable fact that they were 99.86% accurate. *See Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 844 (1984) ("We have long recognized that considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer, and the principle of deference to administrative interpretations." (internal citations omitted)).

The *de minimis* exception articulated by Chairman Williams and the legislative history clearly contemplate some form of a quantitative analysis, even if not in "absolute" terms.[7] There

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[6] ". . . though not in absolute, quantitative terms."

[7] The Division's Opposition also suggests that because Mr. Pruitt argues for a *de minimis* exception to the words "in reasonable detail," he effectively concedes that the OIP states legally sufficient books and records claims for violations of Section 13(b)(5) and Rule 13b2-1 which do not include the same language.[7] This argument lacks merit because the books and records were

is no other meaningful way to express a *de minimis* limit but in quantitative terms. In fact, Chairman Williams indicates that reasonableness, as a standard, "allows flexibility in responding to particular facts and circumstances. Inherent in this concept is a toleration of deviations from the absolute." 17 C.F.R. Part 241 at 11546. Since the Division cannot credibly argue that 14/100th of one percent ($17.9 million out of $12.622 billion) is anything other than *de minimis* it inappropriately focuses on factual allegations that have nothing whatsoever to do with determining the validity of the violations alleged in the OIP.

In addition, the Division neglects to inform the Court that the $17.9 million was only a tiny portion of what L3 ultimately amended in its filings. L3 disclosed in its amendments that it was revising its financial statements to record aggregate pre-tax charges of $94 million in the Aerospace Systems segment for periods prior to 2011 up to 2013, and approximately $75 million for the first and second quarters of 2014, for a total of $169 million for the segment.[8] According to L3's filings, of these adjustments, $69 million were attributable to the C-12 Contract at the Army Sustainment Division of L3.[9] Of this $69 million, only $15.4 million in pre-tax income was related to the invoices at issue.[10] There was more than $153 million in adjustments that had nothing whatsoever to do with Mr. Pruitt or the allegations of the OIP further confirming the *de minimis* nature of these allegations.

The Division relies on *SEC v. Espuelas*, 905 F. Supp. 2d 507 (S.D.N.Y. 2012), which states that liability under Section 13(b)(2)(A) and Rule 13b2-1 "is predicated on standards of

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maintained in the reasonable detail required by the statute and any violations relying on the purportedly inaccurate records must also fail as a matter of law.

[8] OIP ¶¶ 3 42.

[9] *Id.* ¶ 42.

[10] *Id.*

reasonableness."[11] However, this case, and specifically the language quoted does not address the "reasonable detail" standard, nor does it address the fundamental flaw of the Division's pleading which is that the facts alleged do not amount to a violation of the books and records provisions. Similarly, the Division continues to cite to *SEC v. World-Wide Coin Investments, Ltd.*, 567 F. Supp. 724 (N.D. Ga. 1983), but there the Court explicitly stated that "the FCPA provides no guidance, and this court cannot issue any kind of advisory opinion" regarding "in reasonable detail." *Id.* at 749. The court in *World-Wide Coin Investments* also did not review the full legislative history of the statute or otherwise attempt to discern Congressional intent or even consider Chairman Williams' policy statement regarding "in reasonable detail." At best, *World-Wide Coin Investments* provides guidance but is not controlling on this issue. Respondent is not aware of any case that has considered the meaning of "in reasonable detail," reviewed the legislative history of the statute, and considered Chairman Williams' statements. None of the Division's other cases address or discuss the term "reasonable detail."[12] This is a matter the Court must decide and based on the record before it, it is clear that the OIP fails as a matter of law and must be dismissed.

B. The Division's Qualitative Arguments Have No Basis in the Law

In addition to the failure to allege that L3's books and records were not kept in reasonable detail, the Division puts forth its own standard regarding Mr. Pruitt's alleged conduct. According to the Division, "by any quantitative standard other than materiality to investors," "the $17.9 million accounting misconduct was **extremely significant**" (emphasis added).[13] This made-up standard has no basis in the securities laws or its jurisprudence and the Division cites no

[11] Opposition at 10 (citing *Espuelas*, 905 F. Supp. 2d at 525–26).
[12] The Division also implies that the books and records provisions were intended to target knowing and reckless conduct. This ignores the original intent and purpose of these provisions. *See* H.R. Rep. No. 94-831, at 10.
[13] Opposition at 15.

legal authority providing for such a standard. Nonetheless, applying the "extremely significant" standard, the Division offers a list of items, none of which are relevant legally or factually, to the issues in this Motion. Suggesting, for example, that the invoices at issue prompted an internal investigation by L3 not only tells an incomplete story,[14] but also has nothing to do with the kind of quantitative standard intended by the statute nor does it have any applicability to the violations at issue here. The Division's laundry list of items in support of their invented "extremely significant" standard is nothing more than a distraction that misses the primary issue—that L3's books and records were maintained in the manner required by statute, and therefore no secondary violation can exist. The OIP fails as a matter of law.

II. THE DIVISION STILL FAILS TO IDENTIFY AN INTERNAL CONTROL THAT WAS CIRCUMVENTED

Even after having been ordered by the Court to provide a more definite statement identifying the circumvented internal control, the Division continues to dance around this requirement admitting that it has failed to do so in violation of the Court's order. The appropriate remedy for this continued failure is dismissal of the Section 13(b)(5) charge.

In its June 23, 2017 Order, the Court specifically stated that it is reasonable to inform Mr. Pruitt which internal control forms the basis of the Division's Section 13(b)(5) charge.[15] The Court further noted that this is "especially true here, where the OIP alleges that Pruitt violated one 'specific internal control' but the Division asserts that Pruitt violated at least three internal controls and perhaps more within a collection of almost 500 internal controls."[16] The Division was ordered to rectify this intentional ambiguity so that Mr. Pruitt would not be made to guess

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[14] *See* OIP ¶¶ 3, 42.

[15] Order Granting in Part Motion for More Definite Statement, Admin. Proc. Rulings Release No. 4888, *In the Matter of David Pruitt, CPA*, Admin. Proc. File No. 3-17950, at 4 (June 23, 2017).

[16] *Id.*

which control he circumvented while he prepares his defense. Instead of doing so, the Division provided a list of 16 internal controls that it deems relevant, however minimally, to the alleged violation, yet continues to focus on only one internal control in its Opposition. In order to avoid providing the additional detail ordered by the Court, the Division now claims the internal controls violation is based on Mr. Pruitt's circumvention of "a system of internal accounting controls."[17] This language appears only in paragraph 44 of the OIP, but that paragraph simply restates the language of Section 13(b)(5) and provides no factual substance to support any such violation. The OIP is entirely devoid of a single allegation that sets forth what "system of internal accounting controls" Mr. Pruitt knowingly circumvented. It is obvious that the Division still intends, despite the Court's Order, to pull a surprise at trial and not identify the pertinent internal control it claims was circumvented. The Court should not allow the Division to shift its position yet again and the charge should be dismissed. At a minimum, the Division should be ordered again to state once and for all the specific control it alleges was circumvented.

In fact the only specific allegation in the OIP regarding the circumvented internal control relates to a control that purports to require the delivery of invoices to a customer.[18] In support of this allegation the Division continues to rely on IR 4 as the relevant control. Despite the Division's attempts to rewrite and misconstrue the plain language of IR 4, it simply does not require delivery of an invoice and only pertains to posting of the invoice. IR 4 also does not address the recognition of revenue.[19] The Division's citation to the Process Narrative does not change this fact as that document describes how to comply with IR 4's posting requirements and

[17] Opposition at 17.
[18] OIP ¶ 39.
[19] *See* Hirce Aff. Ex. A at L3-DOJ-SEC-0000478754–55.

makes no mention of any requirement to deliver an invoice to the customer.[20] The Process Narrative makes no mention of any delivery requirement because the control it describes has no such requirement.

It would be entirely unfair for Mr. Pruitt to be held to have circumvented a control that does not clearly and unambiguously set forth what the Division has alleged Mr. Pruitt knowingly failed to do. L3 simply did not have an internal control that required delivery of invoices to a customer nor did it have an internal control that required delivery of invoices to a customer before revenue could be recognized. Mr. Pruitt cannot commit a knowing violation of something that does not exist. The Division's Opposition does nothing to alter this conclusion and the charge must be dismissed.

CONCLUSION

For the reasons set forth herein, the Court should grant Mr. Pruitt's Motion and dismiss the OIP with prejudice. Mr. Pruitt should not be forced to a hearing on allegations and charges that fail as a matter of law.

Dated: July 26, 2017
New York, New York

By: _____

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[20] *See* Opposition at 3; Declaration of H. Gregory Baker, Esq. in Support of the Division of Enforcement's Opposition to Respondent's Motion for a Ruling on the Pleadings Ex. A at L3-DOJ-SEC-0000244783.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17950

In the Matter of

David Pruitt, CPA

Respondent.

CERTIFICATE OF SERVICE

I, Bari R. Nadworny, an associate of the law firm of Baker & Hostetler LLP located at 45 Rockefeller Plaza, New York, New York 10111, hereby certify that on the 26th day of July, 2017, I caused to be served a true copy of Reply Memorandum in Further Support of Respondent David Pruitt's Motion for a Ruling on the Pleadings via electronic mail upon the following parties and other persons entitled to notice:

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