

HARD COPY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

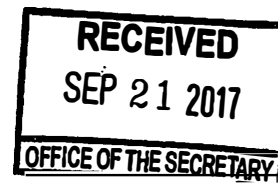
ADMINISTRATIVE PROCEEDING

File No. 3-17950

In the Matter of

David Pruitt, CPA

Respondent.



**DIVISION OF ENFORCEMENT'S MEMORANDUM IN RESPONSE
TO THE COURT'S ORDER FOLLOWING PREHEARING CONFERENCE**

The Division of Enforcement (the "Division") respectfully submits this memorandum in response to the Court's September 6, 2017 Order Following Prehearing Conference.¹

BACKGROUND

On April 28, 2017, the Securities and Exchange Commission issued an order instituting proceedings (the "OIP") alleging that Respondent generated 69 sham invoices in the internal accounting system of L3 Technologies, Inc. ("L3"), a major U.S. government contractor, to improperly recognize \$17.9 million in revenue. The Division has alleged that based on this conduct and the additional factual allegations in the OIP, Respondent caused L3's violations of Section 13(b)(2)(A) of the Securities Exchange Act of 1934 (the "Exchange Act"), and violated Rule 13b2-1 of the Exchange Act, by causing L3 to maintain inaccurate books, records and accounts that in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company. The OIP also alleges that Respondent violated Section 13(b)(5) of

¹ Order Following Prehearing Conference, Admin. Proc. Rulings Release No. 5024, *In the Matter of David Pruitt, CPA*, Admin. Proc. File No. 3-17950 (September 6, 2017) (the "September 6, 2017 Order").

the Exchange Act, by knowingly circumventing a system of internal accounting controls or knowingly falsifying L3's books, records, or accounts.

On June 6, 2017, Respondent moved for a more definite statement, and the Court granted that motion in part on June 23, 2017.² With respect to the internal controls violation, the Court directed that the Division provide Respondent with “[a] list of the internal control or controls that it asserts are relevant to the alleged violation of Exchange Act Section 13(b)(5).” June 23, 2017 Order at 5. On June 30, 2017, the Division submitted a letter to Respondent identifying sixteen specific internal accounting controls.³

On August 11, 2017, Respondent filed a motion to compel the Division to comply with the Court's June 23, 2017 Order, and the Division opposed Respondent's motion on August 18, 2017.⁴ In its opposition, the Division stated that its “position is clear: the controls that are relevant to the Section 13(b)(5) violation are those that the Division identified in the June 30, 2017 Letter.” August 18, 2017 Opp. at 4. On September 6, 2017, the Court conducted a prehearing conference to discuss Respondent's motion. During the conference, the Court asked Respondent whether it would satisfy his concerns if the 16 controls identified in the June 30, 2017 Letter constituted the universe of controls that are included in the alleged violation of

² Admin. Proc. Rulings Release No. 4888, *In the Matter of David Pruitt, CPA*, Admin Proc. File No. 3-17950 (June 23, 2017) (the “June 23, 2017 Order”).

³ Letter from Paul G. Gizzi to John J. Carney dated June 30, 2017 (the “June 30, 2017 Letter”).

⁴ Respondent's Motion to Compel the Division of Enforcement to Comply with the Court's June 23, 2017 Order, *In the Matter of David Pruitt, CPA*, Admin. Proc. File No. 3-17950 (Aug. 11, 2017); Division of Enforcement's Opposition to Respondent's Motion to Compel, *In the Matter of David Pruitt, CPA*, Admin. Proc. File No. 3-17950 (Aug. 18, 2017) (the “August 18, 2017 Opp.”).

Exchange Act Section 13(b)(5).⁵ Respondent indicated that it would address his concerns, and the Court denied his motion to compel as moot. *See* Exhibit A at 38:11-23

During the September 6, 2017 prehearing conference, in response to a question from the Court, the Division offered to file a supplemental submission identifying the factual allegations in the OIP that are relevant to the internal controls charge against Respondent. *See* Exhibit A 35:1-7. The Court directed the Division to provide “a brief detailing the factual allegations in the OIP that support the ‘system of internal accounting controls’ charge.” September 6, 2017 Order. The Division respectfully submits this memorandum in response to the Court’s September 6, 2017 Order.

ARGUMENT

The OIP alleges that in December 2013, Respondent David Pruitt generated 69 fictitious invoices in L3’s internal accounting system to unlawfully recognize \$17.9 million in revenue, which triggered a year-end bonus for Respondent. The OIP provides substantial detail regarding Respondent’s conduct, including his efforts to conceal his misconduct from L3’s corporate office and external auditor.

Section 13(b)(5) of the Exchange Act prohibits any person from knowingly circumventing or failing to implement a system of internal accounting controls, or knowingly falsifying any book, record, or account described in Section 13(b)(2) of the Exchange Act. As a general matter, all of the allegations in the OIP regarding Respondent’s recognition of revenue in violation of Generally Accepted Accounting Principles (“GAAP”), misrepresentations regarding

⁵ The transcript of the September 6, 2017 Prehearing Conference is attached as Exhibit A to the September 20, 2017 declaration of H. Gregory Baker.

his failure to prepare “Estimates at Completion,”⁶ direction to generate invoices but withhold them from the United States Army, and concealment of his misconduct from L3’s corporate office and the company’s external auditor are relevant to the alleged internal controls violation. *See* OIP ¶¶ 2, 4, 9, 11-42. With respect to the internal accounting controls identified in the Division’s June 30, 2017 Letter, the Division identifies below specific allegations within the OIP that are of particular relevance to each internal control.⁷

A. Revenue Recognition: Controls FR 4A and FR 4B

FR 4A (Revenue Recognition Evaluation) requires that the Army Sustainment Division’s (“ASD”)⁸ finance department perform a revenue recognition evaluation “for each revenue arrangement at its inception or before revenue is recorded to [among other things] ... select the revenue recognition method for each unit of accounting and obtain an accounting review and approval from the L-3 Corporate Controller’s Office, when required....” FR 4A also requires that the finance department “evaluate and document[] ... whether there is formal customer acceptance provisions for any of the deliverable(s)” and “whether there are any ‘conditions precedent(s)’ that must be satisfied before the revenue arrangement becomes legally enforceable (e.g., ... proper approval/authorization by the customer....)”.

⁶ Estimates at Completion (“EAC”) allowed divisions to project revenue and profit, and were therefore relied on to create forecasts and the annual operating plan. OIP ¶ 17.

⁷ The internal accounting controls discussed below are attached as Exhibit B to the September 20, 2017 declaration of H. Gregory Baker. Although the June 30, 2017 Letter referenced 16 internal accounting controls, in an effort to narrow the disputes for trial, the Division intends to eliminate one control that it had previously identified – IR 6 – from the Section 13(b)(5) charge against Respondent. Pursuant to the September 6, 2017 Order, the Division reserves the right to include IR 6 (or any other internal control) as part of the “system of internal accounting controls,” if it subsequently determines that this control is relevant and can show cause for including it. *See* September 6, 2017 Order.

⁸ Respondent served as the Vice President of Finance for ASD starting in January 2013, until he was reassigned for performance reasons in January 2014. OIP ¶ 4.

The OIP alleges that the United States Army did not provide the requisite approvals for the revenue that Respondent recognized. OIP ¶¶ 2, 9, 12, 14-19, 33-36; *see also* OIP ¶¶ 20-24. Respondent directed that ASD recognize revenue based on unresolved claims *before* negotiations with the United States Army had even started. OIP ¶¶ 12, 18-21, 30, 33-36.

FR 4B (Revenue Recognition Evaluation) provides that “[t]he selection of revenue recognition methodology is reviewed and approved by the VP of Finance/Controller. The approval is documented in the Revenue Arrangement File.”

The OIP alleges that Respondent, the former Vice President of Finance and principal accounting officer at ASD (OIP ¶ 4), knowingly reviewed and approved a revenue recognition methodology that violated GAAP. Respondent directed employees at ASD to generate invoices (which led to the recognition of revenue on L3’s financial statements) but withhold those invoices from the United States Army. *See* OIP ¶¶ 22-24. Respondent took substantial steps to conceal his misconduct from L3’s corporate office and the company’s external auditor. *See* OIP ¶¶ 30-38. The OIP also provides that Respondent did not document what he euphemistically referred to as his “technique” to recognize revenue. *See* OIP ¶ 25.

B. *Estimates at Completion: Controls FR 5A, FR 5B, FR 5C, FR 25B, and EAC 14*

FR 5A requires ASD to prepare an EAC either annually or quarterly for various contracts. This control also provides that “[e]ach contract EAC ... shall be signed and dated by the preparer and reviewed, approved, and signed ... by the Division’s VP of Finance/Controller [or his or her designee].” FR 5B provides that, as part of the EAC process, ASD must prepare accurate cost reserves. FR 5C requires that the vice president of finance or controller review and approve changes to EACs. FR 25B (Reporting Major Contract EACs) provides that information from EACs regarding “Major Contracts,” which include certain fixed-price contracts (including

the contract that is relevant to this case), cost-plus contracts, and all contracts that are 25% or greater of a division's sales, must be provided to the corporate controller's office on a schedule, which includes, among other items, various metrics regarding revenue and profit. EAC 14 (Contract Value) provides that "[t]he contract value used on the Contract EAC does not include amounts for unsettled claims, Request for Equitable Adjustments (REA's) and unapproved change orders with the customer unless consulted with and approved by the Corporate Controller's Office."

The OIP alleges that Respondent did not prepare EACs for the C-12 Contract⁹ while the contract was in effect as he was required to do. OIP ¶ 17. Respondent falsely represented to the Aerospace Systems¹⁰ CFO and others at group meetings that EACs were completed for each option year. *Id.* Respondent directed that ASD recognize revenue based on unresolved claims before negotiations with the United States Army had even started. OIP ¶¶ 12, 18-21, 30, 33-36.

C. *Unapproved Change Orders with Respect to Both Scope and Price: FR 8A*

FR 8A provides that "[t]he Finance Department ensures that no revenue or profit is recorded, or costs deferred and capitalized into inventory on Unpriced Change Orders which are in dispute or unapproved by the customer in regard to both scope of work and price **without obtaining approval from the L-3 Corporate Controller's Office.**" (emphasis in original). That control also notes "**[t]his consultation is mandatory for each Unapproved Change Orders ... (a) which individually is \$250,000 or more, and is 1% or more of pre-tax**

⁹ The improperly recognized revenue was related to a fixed-price aircraft maintenance contract between ASD and the U.S. Army, referred to as the C-12 Contract. OIP ¶ 1.

¹⁰ Aerospace Systems is one of four business segments of L3. Each business segment is comprised of multiple business "sectors," and each business sector is comprised of multiple business "divisions." The Aerospace Systems segment is two corporate levels above ASD.

operating income, or (b) which in the aggregate for the current fiscal year is \$1,000,000 or more and is 5% or more of pre-tax operating income.” (emphasis in original).

As alleged in the OIP, Respondent did not consult with L3’s corporate office regarding the appropriate accounting treatment for these items (OIP ¶¶ 21, 24), and concealed his misconduct from L3’s corporate office. OIP ¶¶ 33-36.

D. Claims and Requests for Equitable Adjustments: FR 9

FR 9 provides that “[t]he Finance Department ensures that no revenue or profit is recorded, or costs deferred and capitalized into inventory, on a claim or request for equitable adjustment, without first obtaining approval from the L-3 Corporate Controller’s Office.” That control also notes “[t]his consultation is mandatory for all revenue arrangements with claims and requests for equitable adjustments which individually are equal to or greater than \$250,000.” (emphasis in original).

Respondent directed that ASD recognize revenue based on unresolved claims before negotiations with the United States Army had even started. OIP ¶¶ 12, 18-21, 30, 33-36. Respondent did not consult with L3’s corporate office regarding the appropriate accounting treatment for these items, OIP ¶¶ 21, 24, and concealed his misconduct from L3’s corporate office. OIP ¶¶ 33-36.

E. Quarterly Unbilled Contract Receivable NRV Assessment: FR 10

FR 10 requires that the “Finance Department review[] and assess[] the value and expected collectability of all Unbilled Contract Receivables on a quarterly basis This assessment must also ensure that there are no contracts, orders or jobs with ‘negative backlog,’ indicating that revenue may have been recognized for amounts greater than the contract value or selling price.” (emphasis in original).

As alleged in the OIP, Respondent recognized revenue based on cost overruns and over and above items that exceeded the amounts contained within the C-12 contract. *See* OIP ¶¶ 8, 37; *see also* ¶¶ 10-15. Rather than assess the collectability of these unbilled claims, Respondent ordered his subordinates to recognize revenue even though collectability was *not* reasonably assured, as is required by GAAP. OIP ¶ 40.

F. Management Certifications: FR 23

FR 23 requires that “the President and VP of Finance or Controller obtain a written representation ... in connection with the preparation of the financial statements from personnel reporting directly to them that states that the signer is: i) not aware of any fraud involving management, employees or any third parties ... [and] ii) the financial statements are in accordance with GAAP and L-3 Corporate Accounting Policies....”

Respondent, the Vice President of Finance at ASD (OIP ¶ 4), knew that as a result of his improper revenue recognition, L3’s financial statements were not prepared in accordance with GAAP and L3’s corporate accounting policies. The OIP alleges that Respondent violated GAAP by directing employees of ASD to generate invoices (which led to the recognition of revenue on L3’s financial statements) but withhold those invoices from the United States Army. *See* OIP ¶¶ 22-24. Respondent took substantial steps to conceal his misconduct from L3’s corporate staff and the company’s external auditor. *See* OIP ¶¶ 30-38.

G. Invoicing and Receivables: IR 2 and 3A

IR 2 provides that “[t]he Invoicing Department accumulates and retains the data necessary to prepare and support billings to customers on timely (sic) basis in accordance with the billing terms and methods for each Revenue Arrangement.”

As alleged in the OIP, Respondent directed a subordinate to create 69 invoices in L3’s

internal accounting software and withhold delivery of those invoices from the United States Army. OIP ¶¶ 2, 21-25. Respondent did not use the appropriate billing terms and methods for the C-12 contract revenue arrangement. *See* OIP ¶¶ 12-15, 21-25.

IR 3A requires, among other things, that the preparer of the invoice “must ensure the invoiced amounts reconcile” with values and sales prices that are specified in ASD’s contracts with customers.

The OIP alleges that the invoices were based on estimates of how much money “ASD was likely to recover ...based on their history of negotiations with the government.” OIP ¶ 14. Respondent recognized revenue based on cost overruns and over and above items that exceeded the amounts contained within the C-12 contract. *See* OIP ¶¶ 8, 37; *see also* ¶¶ 10-15.

H. *Invoicing and Receivables: IR 4*

IR 4 provides that “[t]he Finance Department posts each invoicing transaction upon its preparation and distribution to the customer to a separate subsidiary ledger or general ledger account for each type of billing method used by the Financial Reporting Location, which records information about the invoice”

The OIP alleges that Respondent directed that the invoices corresponding to the \$17.9 million in revenue that was impermissible recognized be withheld from the U.S. Army. OIP ¶¶ 2, 20-25, 39.

I. *Invoicing and Receivables: IR 5*

IR 5 requires that “[a]n individual in the Finance Department at a supervisory level, reviews each invoice for the invoice information listed above in Control No. (3), and the items listed below [including among other things, unallowable costs, unresolved billing disputes, and

ensuring that unit price and unit quantity match the purchase or sales orders] ... and approves the customer invoice prior to its submission to the customer”


The OIP alleges that Respondent, the Vice President of Finance at ASD (OIP ¶ 4), directed that ASD recognize \$17.9 million in impermissible revenue and withhold the corresponding invoices from the United States Army. OIP ¶¶ 2, 20-25, 39. Respondent caused L3 to recognize revenue notwithstanding the fact that he knew that the billing disputes with the United States Army had not been resolved (and that the Army would not even consider these claims until 2014). OIP ¶¶ 12, 18-21, 30, 33-36.

CONCLUSION

The Division respectfully submits this memorandum in response to the Court’s September 6, 2017 Order.

Dated: September 20, 2017
New York, New York

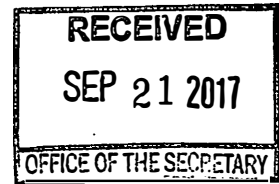
DIVISION OF ENFORCEMENT

By: 
H. GREGORY BAKER
PAUL G. GIZZI
DAVID OLIWENSTEIN
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Securities and Exchange Commission
200 Vesey Street, Suite 400
New York, NY 10281

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

HARD COPY

ADMINISTRATIVE PROCEEDING
File No. 3-17950



In the Matter of,

David Pruitt, CPA,

Respondent.

**DECLARATION OF H. GREGORY BAKER, ESQ. IN SUPPORT
OF THE DIVISION OF ENFORCEMENT'S MEMORANDUM
FOLLOWING PREHEARING CONFERENCE**

I, H. GREGORY BAKER, pursuant to 28 U.S.C. § 1746, declare as follows:

1. I am presently employed as Senior Counsel in the Division of Enforcement in the New York Regional Office of the Securities and Exchange Commission. I submit this declaration in support of the Division of Enforcement's September 20, 2017 Memorandum Following Prehearing Conference.

2. Attached hereto as Exhibit A is a true and correct copy of a transcript of the September 6, 2017 Prehearing Conference conducted in this matter.

3. Attached hereto as Exhibit B is a true and correct copy of excerpts of L3 Technologies, Inc.'s Internal Controls Over Financial Reporting All Processes, dated September 19, 2013.

-----Continued on next page-----

I declare under the penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on September 20, 2017 in New York, NY.

A handwritten signature in black ink, appearing to read "H. Gregory Baker", written over a horizontal line.

H. Gregory Baker
U.S. Securities and Exchange Commission
200 Vesey Street, Suite 400
New York, NY 10281
Phone: (212) 336-9147

Exhibit A

THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)
) File No. 3-17950
DAVID PRUITT, CPA)

ADMINISTRATIVE PROCEEDING - PRE-HEARING CONFERENCE

PAGES: 18 through 46
PLACE: Securities and Exchange Commission
 200 Vesey Street, Suite 400
 New York, NY 10281
DATE: Wednesday, September 6, 2017

The above-entitled matter came on for hearing,
pursuant to notice, at 11:00 a.m.

BEFORE (via telephone):
 JAMES GRIMES, ADMINISTRATIVE LAW JUDGE

Diversified Reporting Services, Inc.
(202) 467-9200

Page 19

1 APPEARANCESe
 2
 3 On behalf of the Securities and Exchange Commission:
 4 DAVID OLIWENSTEIN, ESQ.
 5 H. GREGORY BAKER, ESQ.e
 6 PAUL GIZZI, ESQ.e
 7 Securities and Exchange Commissione
 8 Division of Enforcemente
 9 200 Vesey Street, Suite 400e
 10 New York, New York 10281e
 11
 12 On behalf of the Witness:
 13 JOHN J. CARNEY, ESQ.
 14 JIMMY FOKAS, ESQ.
 15 MARGARET E. HIRCE, ESQ.
 16 BARI R. NADWORN Y, ESQ.
 17 Baker & Hostetler, LLP
 18 45 Rockefeller Plaza
 19 New York, New York 10111
 20
 21
 22
 23
 24
 25

Page 21

1 had agreed that this proceeding should – the hearing
 2 in this proceeding should be held in New York, but I
 3 had a question about that.
 4 The last sentence of the letter indicates
 5 that Mr. – Mr. Pruitt requests that he be provided
 6 with sufficient confidential meeting space at the
 7 hearing site.
 8 So, Mr. Carney, I was – I was wondering
 9 about exactly who that is directed to, what – what
 10 exactly it is you're – you're looking to have, I
 11 guess, occur?
 12 MR. CARNEY: Well, your Honor, we were
 13 originally, I guess, unclear as to where the location
 14 would be, be it – be it New York or elsewhere, and
 15 whether it would be in the Commission's offices or
 16 whether it would be inside a federal building.
 17 And just that because we're going to have,
 18 you know, folks from – you know, from out – from
 19 out of town, we were hoping that – that if it – if
 20 it was at the Commission's site, that the Commission
 21 could – the Division could be kind enough to offer
 22 us, you know, a – basically a prep room and a – and
 23 a witness room, to allow us to move forward
 24 expeditiously; and that if it was going to be at a
 25 federal – a federal building, that the – the Court

Page 20

1 PROCEEDINGS e
 2 JUDGE GRIMES: Good morning. Today is
 3 Wednesday, September 6, 2017, and we're holding what
 4 I believe is our second telephonic prehearing
 5 conference in the matter of David Pruitt.
 6 For the record, my name is James Grimes;
 7 I'm the administrative law judge in this matter.
 8 So for the record, could I – could I get
 9 appearances for the Division of Enforcement?
 10 MR. OLIWENSTEIN: Yes. Good morning, your
 11 Honor. David Oliwenstein, Paul Gizzi and Greg Baker
 12 on behalf of the Division of Enforcement.
 13 JUDGE GRIMES: All right. Thank you.
 14 And then for Mr. Pruitt?
 15 MR. FOKAS: Good morning, your Honor.
 16 It's – this is Jimmy Fokas, and also with me is John
 17 Carney, Margaret Hirce and Bari Nadworn y.
 18 JUDGE GRIMES: All right. Thank you very
 19 much.
 20 And so, for the record, we're going to deal
 21 with a motion to compel that Mr. Pruitt has filed,
 22 but before we get to that, I want to talk about the
 23 hearing location.
 24 The parties submitted a letter – well, the
 25 Division submitted a letter indicating the parties

Page 22

1 might be able to – or direct that we'll be able to
 2 do that.
 3 We just want to be sure, since we have
 4 these – our – our witnesses, a number of them, you
 5 know, kind of traveling far away, we have a place
 6 to – to actually – I don't want to say warehouse
 7 them, but we're certainly very mindful we don't want
 8 to have gaps in – in – in the proceeding.
 9 So we're just hopeful that we could have
 10 some space and be on an even footing, at least, with
 11 the Division with respect to that.
 12 JUDGE GRIMES: Well, most – I haven't made
 13 arrangements yet, obviously because I didn't know
 14 where the hearing was going to be. But most likely,
 15 if the hearing takes place in New York City, it will
 16 take place in the Eastern District of New York at the
 17 Federal Courthouse in Brooklyn. If we can't arrange
 18 space there, then we'll look to go to the Southern
 19 District. And if not there, then we would probably
 20 try to see if the Tax Court courtroom is available.
 21 So I wouldn't be able to control, you know, access to
 22 a meeting space or – or anything like that.
 23 So given that, does that change your
 24 perspective on where we should hold the hearing in
 25 this – in this case?

1 MR. CARNEY: Well, your Honor, just – you
2 know, I was a government lawyer for a long time
3 myself, and I just – I – I know that if it were in
4 one of the U.S. Attorney's offices, I'm confident
5 that the – the Commission staff is going to get –
6 going to get some room and some space. And – and
7 we're just hoping to be – again, to be on equal –
8 equal footing.

9 But I think we – I think we're still okay
10 with it, your Honor, just mindful of the fact that,
11 you know, the – the greater the ability to – to do
12 that, the greater ability – because we do – we do
13 expect to call a number of witnesses.

14 JUDGE GRIMES: I understand.

15 MR. CARNEY: And so I don't think that tips
16 the – tips it, but – but we certainly – it was
17 certainly more of a request from both – to the Court
18 and – and to – and to our – our friends in the
19 Division, that I think it would work best for
20 everyone.

21 JUDGE GRIMES: I understand. I – you
22 know, I'd be as much a guest as you would be in the
23 courthouse, if they allow us to use one of the – one
24 of their courtrooms. I wouldn't be able to provide
25 you with – with the space that you – that you would

1 I think what one of the other things we're
2 thinking about is just, you know, in terms of
3 there – there's probably going to be a fair amount
4 of documents and a fair amount of exhibits, so even a
5 place to store documents during the hearing so we
6 don't – and especially to the extent that it's going
7 to be in downtown Brooklyn as opposed to Manhattan, I
8 think it would be even – you know, it would be far
9 easier if we were able to store materials there, meet
10 with our witnesses, like Mr. Carney said.

11 To the extent that's possible, that's all
12 we're – we're hopeful to receive, just to make
13 things more efficient.

14 JUDGE GRIMES: Okay. Well, I'm happy to
15 ask if, in trying to secure a courtroom, whether –
16 whether there might be space. And if there is, my
17 office will let you all know and we'll see what
18 happens. But given what – what you said, I will –
19 (Simultaneous conversation.)

20 JUDGE GRIMES: – and attempt to secure a
21 courtroom there.

22 And then once my office has done that, I'll
23 let the parties know exactly where we're going to
24 have the hearing in this matter.

25 MR. GIZZI: Your Honor, this is Paul Gizzi

1 need, although I understand why you would want it.
2 So I – that's why I want to know whether
3 or not New York would still be – you'd still be
4 amenable to having a hearing in New York City?

5 MR. CARNEY: Yes, your Honor, with – I
6 guess with the Court's indulgence that there might
7 just – you know, because depending on where we are,
8 if we're – you know, obviously we have offices in
9 New York and we're up in Rockefeller Center, and
10 just – just some place literally to have witness
11 rooms, you know, available.

12 And I – and I know sometimes, you know,
13 the government – and I've been an attorney on the
14 government side too, where they were able to just
15 give us – GSA was able to just give us a couple of
16 rooms where, you know, we could have – have some
17 space.

18 But we – I understand that the Court
19 wouldn't have complete control over it. But to the
20 extent that we could, you know, have the request in,
21 I think that would – that would still – I think
22 that would still keep – I'd ask my – my co-counsel,
23 Mr. Fokas, if he agrees.

24 MR. FOKAS: Yes, that's correct, your
25 Honor.

1 for the Division. And certainly to the extent that,
2 you know, we have any ability to, we're happy to try
3 to accommodate. Obviously we'd like to have the same,
4 you know, facilities for ourselves.

5 And I also offer one other suggestion,
6 which is that I have done hearings at the – the
7 CFTC's New York office. So if the Court is looking
8 for an alternate location, that's another option.

9 JUDGE GRIMES: What – can you tell us
10 about that location? What can you – I'm sorry, what
11 can you tell us about that location?

12 MR. GIZZI: Well, you know what? It's on
13 Broadway. I don't know the exact number, whether
14 it's 140 Broadway. It's – it's – well, I was about
15 to say it's in the Brown Brothers Harriman building,
16 but I don't know what it's called now. It's just
17 north of the Attorney General's Office on Broadway.

18 JUDGE GRIMES: I was more getting at the
19 facilities and the courtroom they would have there.

20 MR. OLIWENSTEIN: Yeah. Well, they have –
21 they have a hearing room, and we had – you know, we
22 kept all of our materials there during the hearing,
23 so I – I'm sure there would be a way for them to
24 accommodate us.

25 JUDGE GRIMES: All right. Well, I

1 appreciate that. We'll - we'll look into it, I mean
 2 my office will look into it, and I'll let the parties
 3 know.
 4 So why don't we move on to Mr. Pruitt's
 5 motion.
 6 And I'll give counsel for Mr. - Mr. Pruitt
 7 an opportunity to explain your position. So go
 8 ahead, Mr. Carney.
 9 MR. FOKAS: Actually, this is Mr. Fokas.
 10 I - I'll be -
 11 JUDGE GRIMES: All right. Go ahead.o
 12 MR. FOKAS: So I think this is pretty
 13 straightforward, and we hoped it - we - we
 14 originally, when we started this, we hoped this would
 15 be pretty straightforward.
 16 We started out with an order with an OIP
 17 that makes specific reference to a specific internal
 18 control that required the delivery of invoices. We
 19 filed a motion for a more definite statement -
 20 (A discussion was held off the record.)
 21 MR. FOKAS: As I was saying, this began
 22 when we moved for a more definite statement and
 23 asked - specifically one of the things we asked for
 24 on that motion was the - the identity of the
 25 specific internal controls that were - that were at

1 issue here and that the Division would allege Mr.
 2 Pruitt violated. And in response, as - as the Court
 3 knows, the Division listed three controls and then
 4 among others.
 5 One - the Court's order that resulted from
 6 that motion directed the Division to identify - and
 7 in our view, we thought this was - you know, this
 8 was the answer to - to - to the problem - identify
 9 the controls that were relevant to the internal
 10 controls violation.
 11 In response, the Division filed a letter
 12 with 16 internal controls, so - and - and as the
 13 Court's aware, in - in - in various briefings,
 14 there's over 500 internal controls that L3 maintained
 15 during the relevant period, so we're not talking
 16 about a very finite list.
 17 But the Division provided those 16 internal
 18 controls. And we thought - until, you know, the
 19 Division's opposition on a motion for judgment on the
 20 pleadings - that that would be the end of it; that
 21 the Division - although 16 seemed excessive and
 22 seems excessive to us, you know, those would be the
 23 16 control - internal controls that would be at
 24 issue and those would be the 16 internal controls
 25 that, you know, Mr. Pruitt would have to prepare his

1 defense around, be that through expert testimony,
 2 through fact witnesses or what have you.
 3 But in - in - in the Division's
 4 opposition, and what brought us to our motion to
 5 compel, is again a - a statement that the Division
 6 does not believe that the Court ordered it to
 7 identify the, you know, controls that it alleges were
 8 circumvented.
 9 And - and since that time, there's also
 10 been reference to the statutory language of 13(b)(5)
 11 that mentions, you know, failing to implement a
 12 system of internal accounting controls as being a
 13 portion of the violation. The OIP says nothing other
 14 than parroting the statutory language.
 15 So again, we're - we're left with a
 16 situation that we just don't know, as we prepare the
 17 defense and as we try to weed through the 85,000
 18 documents that were provided to us and as we try,
 19 more importantly, to plan our, you know, discovery
 20 strategy for - in - when it comes to the
 21 depositions and the limited number that we're
 22 allotted under the rules, we really don't know where
 23 to begin and end with the internal controls
 24 violation.
 25 And so I think it would be very - it would

1 probably be pretty easy for the Division to just take
 2 the position -
 3 (The reporter requested clarification.)
 4 JUDGE GRIMES: You're fading in and out,
 5 Mr. Fokas. I think that's part of the problem.
 6 MR. FOKAS: I'm sorry.
 7 I think it would be - it would very easy
 8 for the Division to state today, once and for all,
 9 that the 16 internal controls - again, even though
 10 we believe those to be somewhat, you know, excessive,
 11 but that's the entire universe of what they intend to
 12 prove at a hearing that were circumvented by Mr.
 13 Pruitt.
 14 I think that would - that would end our -
 15 end - it would answer our request and our motion to
 16 compel.
 17 And I think the reason, not only -
 18 (Simultaneous speaking.)
 19 MR. FOKAS: - for his defense, but I
 20 think, you know, looking at the statutory language,
 21 the Division is required to prove a knowing
 22 circumvention or a knowing failure to implement.
 23 This is not a - a causing standard, this
 24 is not a negligence standard. This is - this is -
 25 this is knowledge, you know, so - so - so probably

1 one of the – you know, the highest standard under
2 the law, so we believe it's critical for us to
3 understand. And again, I think it would be very
4 simple for the Division to state today on the record
5 that those are the 16 controls, there will be none
6 others.

7 We also think it would be reasonable and it
8 would be a question of fairness that if the Division,
9 at some point, does not intend to litigate all 16
10 internal controls, that they inform Mr. Pruitt in
11 advance of the hearing sufficiently to allow us to,
12 you know, tailor our presentation to the Court and be
13 more efficient in our presentation to the Court.

14 But that – that's where we stand, your
15 Honor.

16 JUDGE GRIMES: All right. I mean, I took
17 all of the pleadings, you know, as a whole as – as
18 an indication that the 16 internal controls were, in
19 essence, the system of internal accounting –
20 accounting controls.

21 Mr. Fokas, did you not take it that way?

22 MR. FOKAS: We – we did not, because it
23 was never – it was – the OIP does not couch it
24 as – in – in that fashion, and the Division's
25 letter did not make it entirely clear to us that

1 our position. As your Honor correctly pointed out, a
2 system of internal controls is the 16 controls that
3 we have identified.

4 I – for those reasons, we do not believe
5 that an order requiring us to definitively state
6 anything is appropriate at this time. We have made
7 it clear in our opposition and we're making it clear
8 today that those are the controls that we are relying
9 on for the violation.

10 To the extent that – as – as your Honor
11 is aware, there is additional discovery that both
12 parties are going to be taking. Both parties plan to
13 engage experts. Respondent has submitted a witness
14 list of trial witnesses, of 57 witnesses, in response
15 to the Court's order last week.

16 It's impossible for the Division to sit
17 here right now and say that, through the course of
18 discovery, we might not identify an additional
19 control that could be relevant to the violation.

20 Is there some other list that the Division
21 is sitting on right now that has any additional –
22 additional controls? Absolutely not. But to the
23 extent this case proceeds through discovery and we
24 identify additional controls, I think it's
25 appropriate for the Division to reserve the right to

1 those 16 internal controls constituted a – the
2 entire system.

3 But it – again, if that's the Division's
4 position, then I think that would give us the
5 necessary clarity to move forward in – in the
6 preparation of our defense.

7 JUDGE GRIMES: Okay. Well, thank you.

8 Who – who wants to address this issue for
9 the Division?

10 MR. OLIWENSTEIN: Your Honor, this is David
11 Oliwenstein, and I'm going to address this issue on
12 behalf of the Division.

13 JUDGE GRIMES: All right. Go ahead.

14 MR. OLIWENSTEIN: Let me start out, your
15 Honor, by saying that our position is clear. And I
16 think we've made this position clear in the letter
17 that we submitted to the Court and Respondent on June
18 30th, but we made our position abundantly clear in
19 our opposition to Respondent's current motion.

20 The controls that we are alleging are
21 relevant to the violation of Exchange Act 13(b)(5)
22 are the 16 controls that we identified in the letter.
23 We are not changing our position. That – the fact
24 that we have used the statutory language which
25 appeared in the OIP itself is not a shift in – in

1 rely on those controls as well.

2 And we can deal with that, your Honor, if
3 and when that happens and if Respondent has an
4 objection to that. And at that point, the appropriate
5 inquiry – which is premature now – will be whether
6 Respondent is prejudiced by adding an additional
7 control to the mix.

8 But this inquiry is one that is impossible
9 to have in a vacuum, and – and our position right
10 now is that we are relying on the 16 controls that
11 the Division has clearly identified over a month ago.

12 JUDGE GRIMES: Well, I – I guess I have
13 few questions.

14 When you responded – or you opposed the
15 motion for a more definite statement, your opposition
16 identified one paragraph in the OIP as being relevant
17 to this allegation, and that's paragraph 39.

18 And so I think, at least in my – in my
19 head, that was the only paragraph that was relevant.
20 It's – then later, it's now apparent that it's not.
21 At least it's apparent to me now. It wasn't apparent
22 before because that's the only one that was relevant.

23 So I was wondering – I would like you to
24 tell me which paragraphs in the OIP, facts – which
25 factual allegations are relevant to this charge.

Page 35

1 MR. OLIWENSTEIN: I think that there are a
2 lot of facts in the OIP that are relevant to this
3 charge.
4 I'm happy to go through some examples with
5 the Court now and, if it would be helpful, to provide
6 the Court with a supplemental submission that lays
7 those out in very precise detail, but –
8 JUDGE GRIMES: That would actually be
9 helpful if you could do that, and I think rule – I'm
10 looking at Rule 222(a), which suggests that that –
11 that that's one of the things that we can discuss.
12 I – I would actually think that would be
13 helpful, because I find I've been somewhat confused
14 by exactly what the Division's position is. So if
15 you could do that, I think that that would be helpful
16 to me, so I could understand exactly what it is
17 you're alleging, and I think – I'm sure it would be
18 helpful to Mr. Pruitt and his counsel. So yes, I –
19 I think I would like that.
20 And what – what is today, the 6th? So
21 let's make that – if you could get that – get that
22 out, file that in two weeks, that would be helpful.
23 MR. OLIWENSTEIN: We – we're happy to do
24 that, your Honor.
25 JUDGE GRIMES: All right. And thank you.

Page 36

1 All right. Do you have anything else you'd
2 like to add before I turn back to Mr. Fokas?
3 MR. OLIWENSTEIN: Not at this time, your
4 Honor.
5 JUDGE GRIMES: All right. Mr. Fokas,
6 what – what are your thoughts?
7 MR. FOKAS: Thank you, your Honor.
8 Just – I think Mr. Oliwenstein, you know,
9 actually did a good job of summing up the – the
10 exact reason why we're here. And – and what I –
11 what I mean by that is that when he says or when the
12 Division takes the position that after three years of
13 an unfettered investigation – a joint investigation
14 that involved sophisticated outside counsel for the
15 company that provided information to the Division –
16 the Division's ability along with the criminal
17 authority's to proffer and interview witnesses at
18 will, along with the Division's unfettered
19 investigative ability to compel testimony and take –
20 and – and also conduct additional interviews and
21 compel additional discovery, that they're still at
22 the point where they want to reserve the ability –
23 despite after all this time, the unfettered access to
24 create and to review the investigative record – to
25 maybe add something in at the last second that they

Page 37

1 may have, you know, I don't know, perhaps overlooked
2 or forgotten, I don't – I think that's the essence
3 of the unfairness here.
4 There shouldn't be – and then that's the
5 reason why, if the Division is – is not willing to
6 definitively and unequivocally state that these are
7 the 16 and these will always and only be the 16
8 controls at issue, that we do require an order from
9 the Court to make that clear.
10 And perhaps, you know, it – it's something
11 that could wait, the additional information that the
12 Division's going to put forth, but I don't think it
13 can at this point. We are on a very tight time line.
14 Our expert discovery, our expert reports are due at
15 the end of October, and we can't be in a position –
16 and nor do I think the Court wants to be in a
17 position – where the Division, you know, turns over
18 one additional rock that it didn't turn over during
19 its – its investigation and find something that they
20 want to, you know, fill in at the last minute.
21 That's just not fair to Mr. Pruitt, that
22 would prejudice his defense. That would likely lead
23 to additional motion practice at that – at that
24 point in time.
25 And so, again, I think we strenuously

Page 38

1 object to sort of, you know, kicking the can down the
2 road and giving the Division an additional
3 opportunity, after – you know, this is not something
4 that just sprung up. This is – this is something
5 that the Division had years to look at, years to
6 formulate its case and – and put a lot of time and
7 effort and thought, presumably, into what it put
8 forth.
9 And so I think, you know, that – that's,
10 again, where we are at this point.
11 JUDGE GRIMES: And if – if we were to –
12 as you said earlier, to just consider the 16 internal
13 controls as the entire universe of – of internal
14 controls as, I guess, essentially be the system, then
15 that would satisfy your concerns; is that correct?
16 MR. FOKAS: Yes, your Honor. I think,
17 again, while we do think 16 – in light of some of
18 the 16 being very, you know, even tangentially related
19 to the facts at issue, while we think that is a bit
20 excessive, I think that would allow us to, you know,
21 inform our – our – our experts and, you know,
22 engage in – in formulating our defense. So yes,
23 your Honor.
24 JUDGE GRIMES: All right. Any last
25 thoughts from the Division?

1 MR. OLIWENSTEIN: Yes, your Honor. I – I
2 just want to respond very briefly to Mr. Fokas' point
3 on prejudice, because I think he's absolutely right.
4 I think that is the – the focus – that should be
5 the focus of the inquiry, to the extent that the
6 Division seeks to add an additional control to the
7 violation. And that is just something that is
8 impossible to evaluate right now in – in a vacuum.

9 For example, there are several controls on
10 the list that the Division identified that relate to
11 what we allege is Respondent's failure to perform
12 estimates at – at completion.

13 If, through expert discovery, the Division
14 identifies an additional control that's relevant to
15 those facts, is that going to be prejudicial to
16 Respondent? Is that going to require any additional
17 preparation? Maybe, maybe not. That's something
18 that's impossible for the Court to assess right now.

19 So we would request that Respondent's
20 motion be – be denied as premature, at the very
21 least.

22 JUDGE GRIMES: All right. Here's what I –
23 here is what I'm going to do: I think it was June,
24 late June – June 23rd, I believe – when I granted,
25 in part, a motion for a more definite statement. And

1 MR. GIZZI: Your Honor, this is Paul Gizzi
2 for the Division. I just would like to note, in
3 response to Mr. Fokas' comments, that the Division
4 has turned over our notes of – of the interviews
5 with all of the witnesses that the Division
6 interviewed.

7 So although Mr. – although Mr. Fokas is –
8 is saying that we've had unfettered access to
9 witnesses in conjunction with the – the U.S.
10 Attorney's Office and interviewed witnesses, we've
11 turned over our notes.

12 So they are – they're basically on a level
13 footing with us, and they're – they're – they're
14 certainly free to interview any of the witnesses they
15 want to interview.

16 JUDGE GRIMES: Okay. Anything else from
17 Mr. Pruitt?

18 MR. FOKAS: Yes, your Honor. This is Mr.
19 Fokas again. I think it – it's actually interesting
20 that – that coun- – that Mr. Gizzi has brought up
21 the issue of the interview memos.

22 We were not going – we do not think the
23 issue had ripened to discuss it, but since the
24 Division has – has brought it up, we were actually
25 in the process of trying to come to a – a – a

1 in that order, I directed the Division to submit a
2 list of internal controls that it asserts are
3 relevant to the violation of Section 13(b)(5). The
4 Division did that.

5 To the extent that the Division would later
6 want to amend that list, I would consider that
7 amendment to be in the nature of – of – to be akin
8 to amending the – the – the OIP. Thus, if the
9 Division proposes to do that, it will have to show
10 cause why it should be allowed to do that by motion,
11 and then Mr. Pruitt would be allowed to respond.

12 So at this point, absent showing cause,
13 we're going to stick to just the 16 internal controls
14 that have been identified.

15 Does anyone have any questions about that?
16 I'll start with Division. Any questions
17 about what I just said?

18 MR. OLIWENSTEIN: Not from the Division,
19 your Honor.

20 JUDGE GRIMES: Mr. Pruitt, do you have any
21 questions or concerns?

22 MR. FOKAS: No, your Honor. Thank you.

23 JUDGE GRIMES: All right. Well, then I'll
24 turn to the Division. Is there anything else we need
25 to talk about this morning?

1 resolution with the Division on the quality of the
2 interview memoranda that they've turned over to us
3 without the Court's intervention.

4 We've had some letters go back and forth
5 and, you know, primarily what – what Mr. Gizzi says
6 is – is unfettered access may not actually be the
7 case, as we still – it's still not clear to us that
8 the Division has turned over all of its interview
9 memoranda or its summaries of, you know, the – the
10 FBI 302s. And we – we've just recently received
11 their response to our letter on this issue.

12 And more fundamentally, we identified,
13 again in the hopes that we could – the parties could
14 resolve this amongst themselves, without the Court's
15 intervention, we identified just various what we –
16 we think are pretty significant deficiencies in what
17 the Division has provided to us in – in the form of,
18 you know, the witness summaries.

19 And so we're still in the process of – of
20 ironing those issues out.

21 JUDGE GRIMES: Mr. Fokas, let me cut you
22 off.

23 Are you – are you asking me to do anything
24 this morning?

25 MR. FOKAS: No, your Honor. I just wanted

1 to respond to Mr. Gizzi's point that we've had
2 unfettered access. I don't believe that's the case,
3 and I -- I just -- since they raised the issue, there
4 may be some -- some motion practice down the line if
5 we are unable to resolve it ourselves.

6 JUDGE GRIMES: All right. Well, I --

7 MR. GIZZI: Well, your Honor, if I might --
8 if I might, I didn't say that they've had unfettered
9 access. I was responding to Mr. Fokas' comment that
10 the Division had unfettered access to the witnesses.

11 JUDGE GRIMES: Okay. I'm going to cut off
12 this conversation right here.

13 If the parties are unable to resolve any
14 sort of discovery dispute, obviously I will
15 adjudicate whatever motion is filed. I'm not going
16 to give you a -- actually, you haven't even asked me
17 for any sort of ruling this morning, so that
18 doesn't -- that doesn't really matter.

19 Are there any other issues that we need to
20 address?

21 Mr. Fokas, anything else?

22 MR. FOKAS: No, your Honor. Thank you.

23 JUDGE GRIMES: Anything else from the
24 Division?

25 MR. OLIWENSTEIN: Nothing from the

1 PROOFREADER'S CERTIFICATE

2
3 In The Matter of: DAVID PRUITT, CPA
4 ADMINISTRATIVE PROCEEDING - PRE-HEARING CONFERENCE

5 File Number: 3-17950

6 Date: Wednesday, September 6, 2017

7 Location: New York, NY

8
9 This is to certify that I, Maria E.

10 Paulsen, (the undersigned), do hereby swear and
11 affirm that the attached proceedings before the U.S.
12 Securities and Exchange Commission were held
13 according to the record and that this is the
14 original, complete, true and accurate transcript that
15 has been compared to the reporting or recording
16 accomplished at the hearing.

17
18 _____
19 (Proofreader's Name) (Date)

1 Division, your Honor. Thank you.

2 JUDGE GRIMES: Okay. Well, then I'll look
3 forward to receiving your memoranda in two weeks, and
4 I guess -- guess that's it then.

5 We are adjourned, and I'll thank everyone
6 for their time. Have a good day.

7 MR. OLIWENSTEIN: Thank you, your Honor.

8 MR. FOKAS: Thank you, your Honor.
9 (Whereupon, at 11:27 a.m., the examination
10 was concluded.)

11 * * * * *

A	18:7,19 20:7 45:4	33:6,25 34:4	26:13,14,17 Brooklyn 22:17 25:7	30:3 clarity 32:5 clear 31:25 32:15,16,18 33:7,7 37:9 42:7 clearly 34:11 co-counsel 24:22 come 41:25 comes 29:20 comment 43:9 comments 41:3 Commission 18:1,9 19:3 19:7 21:20 23:5 45:12 Commissio... 21:15,20 company 36:15 compared 45:15 compel 20:21 29:5 30:16 36:19,21 complete 24:19 45:14 completion 39:12 concerns 38:15 40:21 concluded 44:10 conduct 36:20 conference 18:7 20:5 45:4 confident 23:4 confidential 21:6 confused 35:13 conjunction 41:9	consider 38:12 40:6 constituted 32:1 control 22:21 24:19 27:18 28:23 33:19 34:7 39:6 39:14 controls 27:25 28:3 28:9,10,12 28:14,18,23 28:24 29:7 29:12,23 30:9 31:5 31:10,18,20 32:1,20,22 33:2,2,8,22 33:24 34:1 34:10 37:8 38:13,14 39:9 40:2 40:13 conversation 25:19 43:12 correct 24:24 38:15 correctly 33:1 couch 31:23 coun- 41:20 counsel 27:6 35:18 36:14 couple 24:15 course 33:17 Court 21:25 22:20 23:17 24:18 26:7 28:2 29:6 31:12,13 32:17 35:5 35:6 37:9 37:16 39:18 Court's 24:6 28:5,13 33:15 42:3 42:14 courthouse
a.m 18:15 44:9 ability 23:11 23:12 26:2 36:16,19,22 able 22:1,1 22:21 23:24 24:14,15 25:9 above-entit... 18:14 absent 40:12 absolutely 33:22 39:3 abundantly 32:18 access 22:21 36:23 41:8 42:6 43:2,9 43:10 accommod... 26:3,24 accomplish... 45:16 accounting 29:12 31:19 31:20 accurate 45:14 Act 32:21 add 36:2,25 39:6 adding 34:6 additional 33:11,18,21 33:22,24 34:6 36:20 36:21 37:11 37:18,23 38:2 39:6 39:14,16 address 32:8 32:11 43:20 adjourned 44:5 adjudicate 43:15 administra...	advance 31:11 affirm 45:11 ago 34:11 agreed 21:1 agrees 24:23 ahead 27:8 27:11 32:13 akin 40:7 allegation 34:17 allegations 34:25 allege 28:1 39:11 alleges 29:7 alleging 32:20 35:17 allotted 29:22 allow 21:23 23:23 31:11 38:20 allowed 40:10,11 alternate 26:8 amenable 24:4 amend 40:6 amending 40:8 amendment 40:7 amount 25:3 25:4 answer 28:8 30:15 apparent 34:20,21,21 appearances 19:1 20:9 appeared 32:25 appreciate 27:1 appropriate	arrange 22:17 arrangeme... 22:13 asked 27:23 27:23 43:16 asking 42:23 asserts 40:2 assess 39:18 attached 45:11 attempt 25:20 attorney 24:13 26:17 Attorney's 23:4 41:10 authority's 36:17 available 22:20 24:11 aware 28:13 33:11	arranged 26:15 brought 29:4 41:20,24 Brown 26:15 building 21:16,25 26:15	C C 20:1 call 23:13 called 26:16 Carney 19:13 20:17 21:8 21:12 23:1 23:15 24:5 25:10 27:8 case 22:25 33:23 38:6 42:7 43:2 cause 40:10 40:12 causing 30:23 Center 24:9 certainly 22:7 23:16 23:17 26:1 41:14 CERTIFIC... 45:1 certify 45:9 CFTC's 26:7 change 22:23 changing 32:23 charge 34:25 35:3 circumvent... 29:8 30:12 circumvent... 30:22 City 22:15 24:4 clarification	
B	back 36:2 42:4 Baker 19:5 19:17 20:11 Bari 19:16 20:17 basically 21:22 41:12 began 27:21 behalf 19:3 19:12 20:12 32:12 believe 20:4 29:6 30:10 31:2 33:4 39:24 43:2 best 23:19 bit 38:19 briefings 28:13 briefly 39:2 Broadway				

22:17 23:23 courtroom 22:20 25:15 25:21 26:19 courtrooms 23:24 CPA 18:5 45:3 create 36:24 criminal 36:16 critical 31:2 current 32:19 cut 42:21 43:11	28:6 40:1 discovery 29:19 33:11 33:18,23 36:21 37:14 39:13 43:14 discuss 35:11 41:23 discussion 27:20 dispute 43:14 District 22:16,19 Diversified 18:24 Division 19:8 20:9,12,25 21:21 22:11 23:19 26:1 28:1,3,6,11 28:17,21 29:5 30:1,8 30:21 31:4 31:8 32:9 32:12 33:16 33:20,25 34:11 36:12 36:15 37:5 37:17 38:2 38:5,25 39:6,10,13 40:1,4,5,9 40:16,18,24 41:2,3,5,24 42:1,8,17 43:10,24 44:1 Division's 28:19 29:3 31:24 32:3 35:14 36:16 36:18 37:12 documents 25:4,5 29:18 downtown 25:7 due 37:14	E E 19:15 20:1 20:1 45:9 earlier 38:12 easier 25:9 Eastern 22:16 easy 30:1,7 efficient 25:13 31:13 effort 38:7 Enforcement 19:8 20:9 20:12 engage 33:13 38:22 entire 30:11 32:2 38:13 entirely 31:25 equal 23:7,8 especially 25:6 ESQ 19:4,5,6 19:13,14,15 19:16 essence 31:19 37:2 essentially 38:14 estimates 39:12 evaluate 39:8 exact 26:13 36:10 exactly 21:9 21:10 25:23 35:14,16 examination 44:9 example 39:9 examples 35:4 excessive 28:21,22 30:10 38:20 Exchange 18:1,9 19:3 19:7 32:21	45:12 exhibits 25:4 expect 23:13 expeditiously 21:24 expert 29:1 37:14,14 39:13 experts 33:13 38:21 explain 27:7 extent 24:20 25:6,11 26:1 33:10 33:23 39:5 40:5	F facilities 26:4 26:19 fact 23:10 29:2 32:23 facts 34:24 35:2 38:19 39:15 factual 34:25 fading 30:4 failing 29:11 failure 30:22 39:11 fair 25:3,4 37:21 fairness 31:8 far 22:5 25:8 fashion 31:24 FBI 42:10 federal 21:16 21:25,25 22:17 file 18:4 35:22 45:5 filed 20:21 27:19 28:11 43:15 fill 37:20 find 35:13 37:19 finite 28:16 focus 39:4,5	Fokas 19:14 20:15,16 24:23,24 27:9,9,12 27:21 30:5 30:6,19 31:21,22 36:2,5,7 38:16 40:22 41:7,18,19 42:21,25 43:21,22 44:8 Fokas' 39:2 41:3 43:9 folks 21:18 footing 22:10 23:8 41:13 forgotten 37:2 form 42:17 formulate 38:6 formulating 38:22 forth 37:12 38:8 42:4 forward 21:23 32:5 44:3 free 41:14 friends 23:18 fundament... 42:12	G G 20:1 gaps 22:8 General's 26:17 getting 26:18 give 24:15,15 27:6 32:4 43:16 given 22:23 25:18 giving 38:2 Gizzi 19:6 20:11 25:25	25:25 26:12 41:1,1,20 42:5 43:7 Gizzi's 43:1 go 22:18 27:7 27:11 32:13 35:4 42:4 going 20:20 21:17,24 22:14 23:5 23:6 25:3,6 25:23 32:11 33:12 37:12 39:15,16,23 40:13 41:22 43:11,15 good 20:2,10 20:15 36:9 44:6 government 23:2 24:13 24:14 granted 39:24 greater 23:11 23:12 Greg 20:11 GREGORY 19:5 Grimes 18:19 20:2,6,13 20:18 22:12 23:14,21 25:14,20 26:9,18,25 27:11 30:4 31:16 32:7 32:13 34:12 35:8,25 36:5 38:11 38:24 39:22 40:20,23 41:16 42:21 43:6,11,23 44:2 GSA 24:15 guess 21:11 21:13 24:6 34:12 38:14
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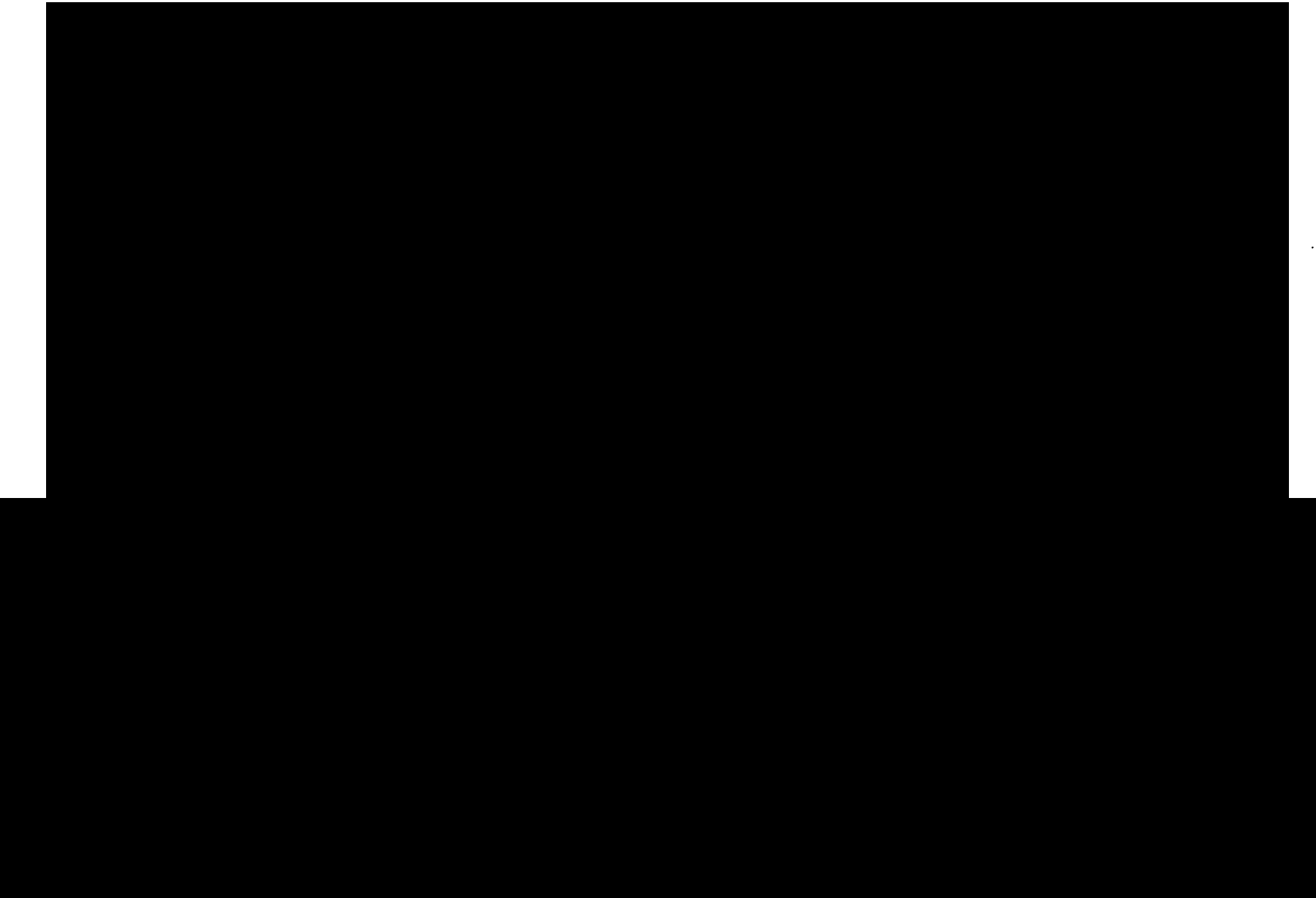
guest 23:22	25:12	28:17,23,24	25:14,20	knows 28:3	28:14
H	hopes 42:13	29:12,23	26:9,18,25	L	making 33:7
H 19:5	hoping 21:19	30:9 31:10	27:11 30:4	L3 28:14	Manhattan
happens	23:7	31:18,19	31:16 32:7	language	25:7
25:18 34:3	Hostetler	32:1 33:2	32:13 34:12	29:10,14	Margaret
happy 25:14	19:17	38:12,13	35:8,25	30:20 32:24	19:15 20:17
26:2 35:4	I	40:2,13	36:5 38:11	late 39:24	Maria 45:9
35:23	identified	intervention	38:24 39:22	law 18:19	materials
Harriman	32:22 33:3	42:3,15	40:20,23	20:7 31:2	25:9 26:22
26:15	34:11,16	interview	41:16 42:21	lawyer 23:2	matter 18:3
head 34:19	39:10 40:14	36:17 41:14	43:6,11,23	lays 35:6	18:14 20:5
hearing	42:12,15	41:15,21	44:2	lead 37:22	20:7 25:24
18:14 20:23	identifies	42:2,8	judgment	left 29:15	43:18 45:3
21:1,7	39:14	interviewed	28:19	let's 35:21	mean 27:1
22:14,15,24	identify 28:6	41:6,10	June 32:17	letter 20:24	31:16 36:11
24:4 25:5	28:8 29:7	interviews	39:23,24,24	20:25 21:4	meet 25:9
25:24 26:21	33:18,24	36:20 41:4	K	28:11 31:25	meeting 21:6
26:22 30:12	identity	investigation	keep 24:22	32:16,22	22:22
31:11 45:16	27:24	36:13,13	kept 26:22	42:11	memoranda
hearings 26:6	implement	37:19	kicking 38:1	letters 42:4	42:2,9 44:3
held 21:2	29:11 30:22	investigative	kind 21:21	level 41:12	memos 41:21
27:20 45:12	importantly	36:19,24	22:5	light 38:17	mentions
helpful 35:5	29:19	invoices	know 21:18	limited 29:21	29:11
35:9,13,15	impossible	27:18	21:18,22	line 37:13	mindful 22:7
35:18,22	33:16 34:8	involved	22:5,13,21	43:4	23:10
highest 31:1	39:8,18	36:14	23:2,3,11	list 28:16	minute 37:20
Hirce 19:15	indicates	ironing 42:20	23:22 24:2	33:14,20	mix 34:7
20:17	21:4	issue 28:1,24	24:7,8,11	39:10 40:2	month 34:11
hold 22:24	indicating	32:8,11	24:12,12,16	40:6	morning 20:2
holding 20:3	20:25	37:8 38:19	24:20 25:2	listed 28:3	20:10,15
Honor 20:11	indication	41:21,23	25:8,17,23	literally	40:25 42:24
20:15 21:12	31:18	42:11 43:3	26:2,4,12	24:10	43:17
23:1,10	indulgence	issues 42:20	26:13,16,21	litigate 31:9	motion 20:21
24:5,25	24:6	43:19	27:3 28:7	LLP 19:17	27:5,19,24
25:25 31:15	inform 31:10	J	28:18,22,25	location	28:6,19
32:10,15	38:21	J 19:13	29:7,11,16	20:23 21:13	29:4 30:15
33:1,10	information	James 18:19	29:19,22	26:8,10,11	32:19 34:15
34:2 35:24	36:15 37:11	20:6	30:10,20,25	45:7	37:23 39:20
36:4,7	inquiry 34:5	Jimmy 19:14	31:1,12,17	long 23:2	39:25 40:10
38:16,23	34:8 39:5	20:16	36:8 37:1,1	look 22:18	43:4,15
39:1 40:19	inside 21:16	job 36:9	37:10,17,20	27:1,2 38:5	move 21:23
40:22 41:1	intend 30:11	John 19:13	38:1,3,9,18	44:2	27:4 32:5
41:18 42:25	31:9	20:16	38:20,21	looking 21:10	moved 27:22
43:7,22	interesting	joint 36:13	42:5,9,18	26:7 30:20	N
44:1,7,8	41:19	judge 18:19	knowing	35:10	N 20:1
hoped 27:13	internal	20:2,7,13	30:21,22	lot 35:2 38:6	Nadworny
27:14	27:17,25	20:18 22:12	knowledge	M	19:16 20:17
hopeful 22:9	28:9,12,14	23:14,21	30:25	maintained	name 20:6

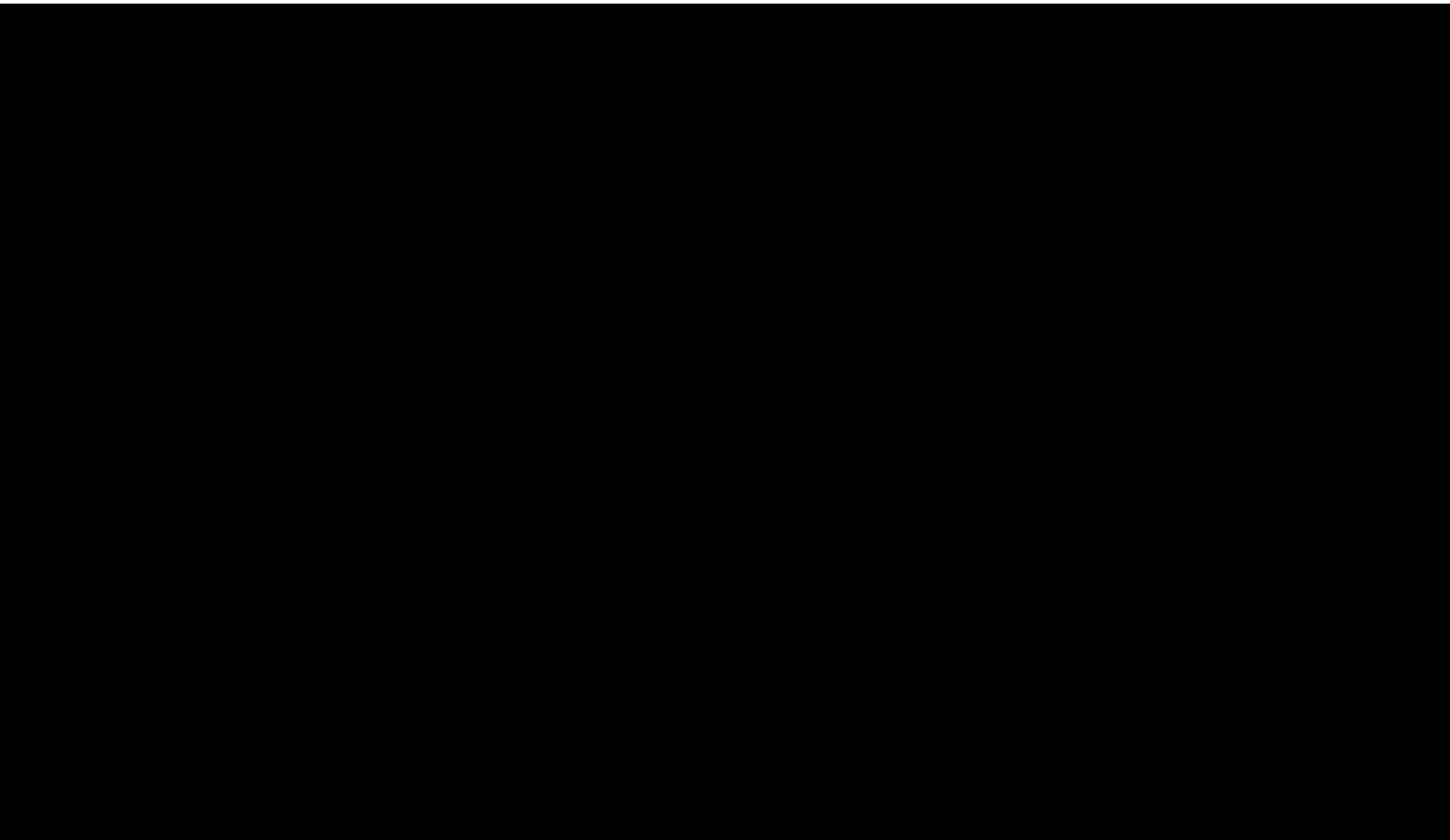
45:19	40:8	20:25 25:23	prejudicial	30:13 31:10	relying 33:8
nature 40:7	okay 23:9	27:2 33:12	39:15	35:18 37:21	34:10
necessary	25:14 32:7	33:12 42:13	premature	40:11,20	reporter 30:3
32:5	41:16 43:11	43:13	34:5 39:20	41:17 45:3	reporting
need 24:1	44:2	Paul 19:6	prep 21:22	Pruitt's 27:4	18:24 45:15
40:24 43:19	Oliwenstein	20:11 25:25	preparation	pursuant	reports 37:14
negligence	19:4 20:10	41:1	32:6 39:17	18:15	request 23:17
30:24	20:11 26:20	Paulsen	prepare	put 37:12	24:20 30:15
never 31:23	32:10,11,14	45:10	28:25 29:16	38:6,7	39:19
New 18:11	35:1,23	perform	presentation		requested
19:10,10,19	36:3,8 39:1	39:11	31:12,13	Q	30:3
19:19 21:2	40:18 43:25	period 28:15	presumably	quality 42:1	requests 21:5
21:14 22:15	44:7	perspective	38:7	question 21:3	require 37:8
22:16 24:3	once 25:22	22:24	pretty 27:12	31:8	39:16
24:4,9 26:7	30:8	place 18:9	27:15 30:1	questions	required
45:7	opportunity	22:5,15,16	42:16	34:13 40:15	27:18 30:21
north 26:17	27:7 38:3	24:10 25:5	primarily	40:16,21	requiring
note 41:2	opposed 25:7	plan 29:19	42:5	R	33:5
notes 41:4,11	34:14	33:12	probably	R 19:16 20:1	reserve 33:25
notice 18:15	opposition	Plaza 19:18	22:19 25:3	raised 43:3	36:22
number 22:4	28:19 29:4	pleadings	30:1,25	really 29:22	resolution
23:13 26:13	32:19 33:7	28:20 31:17	problem 28:8	43:18	42:1
29:21 45:5	34:15	point 31:9	30:5	reason 30:17	resolve 42:14
NY 18:11	option 26:8	34:4 36:22	proceeding	36:10 37:5	43:5,13
45:7	order 27:16	37:13,24	18:7 21:1,2	reasonable	respect 22:11
O	28:5 33:5	38:10 39:2	22:8 45:4	31:7	respond 39:2
O 20:1	33:15 37:8	40:12 43:1	proceedings	reasons 33:4	40:11 43:1
object 38:1	40:1	pointed 33:1	45:11	receive 25:12	responded
objection	ordered 29:6	portion 29:13	proceeds	received	34:14
34:4	original	position 27:7	33:23	42:10	Respondent
obviously	45:14	30:2 32:4	process 41:25	receiving	32:17 33:13
22:13 24:8	originally	32:15,16,18	42:19	44:3	34:3,6
26:3 43:14	21:13 27:14	32:23 33:1	proffer 36:17	record 20:6,8	39:16
occur 21:11	outside 36:14	34:9 35:14	Proofread...	20:20 27:20	Responden...
October	overlooked	36:12 37:15	45:1,19	31:4 36:24	32:19 39:11
37:15	37:1	37:17	proposes	45:13	39:19
offer 21:21	P	possible	40:9	recording	responding
26:5	P 20:1	25:11	prove 30:12	45:15	43:9
office 25:17	PAGES 18:8	practice	30:21	reference	response 28:2
25:22 26:7	paragraph	37:23 43:4	provide	27:17 29:10	28:11 33:14
26:17 27:2	34:16,17,19	PRE-HEA...	23:24 35:5	relate 39:10	41:3 42:11
41:10	paragraphs	18:7 45:4	provided	related 38:18	resulted 28:5
offices 21:15	34:24	precise 35:7	21:5 28:17	relevant 28:9	review 36:24
23:4 24:8	parroting	prehearing	29:18 36:15	28:15 32:21	right 20:13
OIP 27:16	29:14	20:4	42:17	33:19 34:16	20:18 26:25
29:13 31:23	part 30:5	prejudice	Pruitt 18:5	34:19,22,25	27:11 31:16
32:25 34:16	39:25	37:22 39:3	20:5,14,21	35:2 39:14	32:13 33:17
34:24 35:2	parties 20:24	prejudiced	21:5 27:6	40:3	33:21,25
		34:6	28:2,25	rely 34:1	34:9 35:25

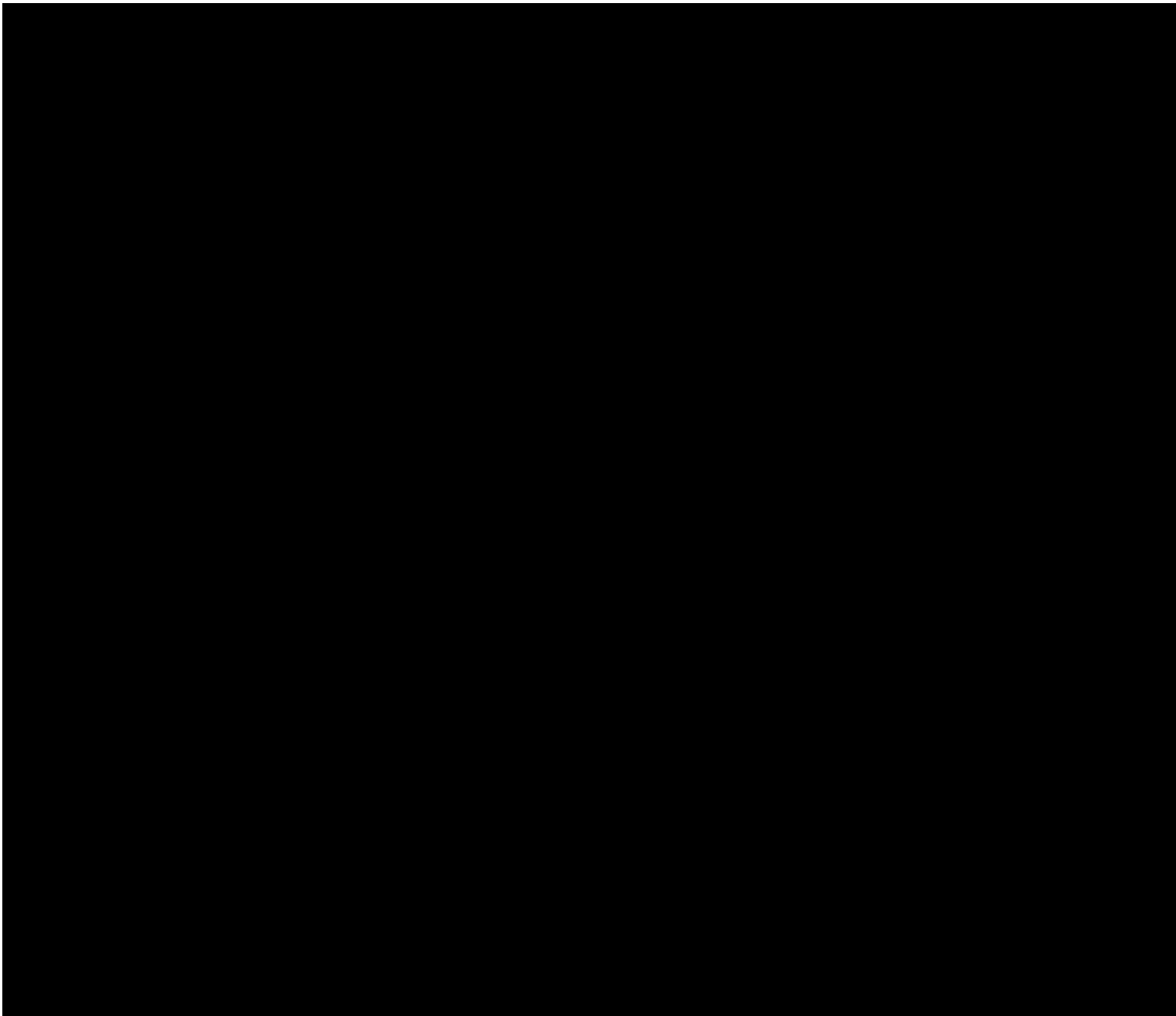
36:1,5	significant	statutory	talk 20:22	tight 37:13	41:8 42:6
38:24 39:3	42:16	29:10,14	40:25	time 23:2	43:2,8,10
39:8,18,22	simple 31:4	30:20 32:24	talking 28:15	29:9 33:6	UNITED
40:23 43:6	Simultaneo...	stick 40:13	tangentially	36:3,23	18:1
43:12	25:19 30:18	store 25:5,9	38:18	37:13,24	universe
ripened	sit 33:16	straightfor...	Tax 22:20	38:6 44:6	30:11 38:13
41:23	site 21:7,20	27:13,15	telephone	tips 23:15,16	use 23:23
road 38:2	sitting 33:21	strategy	18:18	today 20:2	
rock 37:18	situation	29:20	telephonic	30:8 31:4	V
Rockefeller	29:16	Street 18:10	20:4	33:8 35:20	vacuum 34:9
19:18 24:9	somewhat	19:9	tell 26:9,11	town 21:19	39:8
room 21:22	30:10 35:13	strenuously	34:24	transcript	various 28:13
21:23 23:6	sophisticated	37:25	terms 25:2	45:14	42:15
26:21	36:14	submission	testimony	traveling	Vesey 18:10
rooms 24:11	sorry 26:10	35:6	29:1 36:19	22:5	19:9
24:16	30:6	submit 40:1	thank 20:13	trial 33:14	view 28:7
rule 35:9,10	sort 38:1	submitted	20:18 32:7	true 45:14	violated 28:2
rules 29:22	43:14,17	20:24,25	35:25 36:7	try 22:20	violation
ruling 43:17	Southern	32:17 33:13	40:22 43:22	26:2 29:17	28:10 29:13
	22:18	sufficient	44:1,5,7,8	29:18	29:24 32:21
S	space 21:6	21:6	things 25:1	trying 25:15	33:9,19
S 20:1	22:10,18,22	sufficiently	25:13 27:23	41:25	39:7 40:3
satisfy 38:15	23:6,25	31:11	35:11	turn 36:2	
saying 27:21	24:17 25:16	suggestion	think 23:9,9	37:18 40:24	W
32:15 41:8	speaking	26:5	23:15,19	turned 41:4	wait 37:11
says 29:13	30:18	suggests	24:21,21	41:11 42:2	want 20:22
36:11 42:5	specific 27:17	35:10	25:1,8	42:8	22:3,6,7
second 20:4	27:17,25	Suite 18:10	27:12 29:25	turns 37:17	24:1,2
36:25	specifically	19:9	30:5,7,14	two 35:22	36:22 37:20
Section 40:3	27:23	summaries	30:17,20	44:3	39:2 40:6
secure 25:15	sprung 38:4	42:9,18	31:3,7 32:4		41:15
25:20	staff 23:5	summing	32:16 33:24	U	wanted 42:25
Securities	stand 31:14	36:9	34:18 35:1	U.S 23:4 41:9	wants 32:8
18:1,9 19:3	standard	supplemen...	35:9,12,15	45:11	37:16
19:7 45:12	30:23,24	35:6	35:17,19	unable 43:5	warehouse
see 22:20	31:1	sure 22:3	36:8 37:2	43:13	22:6
25:17	start 32:14	26:23 35:17	37:12,16,25	unclear 21:13	wasn't 34:21
seeks 39:6	40:16	swear 45:10	38:9,16,17	undersigned	way 26:23
sentence 21:4	started 27:14	system 29:12	38:19,20	45:10	31:21
September	27:16	31:19 32:2	39:3,4,23	understand	we'll 22:1,18
18:12 20:3	state 30:8	33:2 38:14	41:19,22	23:14,21	25:17 27:1
45:6	31:4 33:5		42:16	24:1,18	27:1
Services	37:6	T	thinking 25:2	31:3 35:16	we're 20:3,20
18:24	statement	tailor 31:12	thought 28:7	unequivoc...	21:17 22:7
shift 32:25	27:19,22	take 22:16	28:18 38:7	37:6	22:9 23:7,9
show 40:9	29:5 34:15	30:1 31:21	thoughts	unfairness	24:8,9 25:1
showing	39:25	36:19	36:6 38:25	37:3	25:12,12,23
40:12	STATES	takes 22:15	three 28:3	unfettered	26:2 28:15
side 24:14	18:1	36:12	36:12	36:13,18,23	29:15,15,21
					33:7 35:23

36:10 40:13	10111 19:19	45:6			
42:19	10281 18:11	6th 35:20			
we've 32:16	19:10				
41:8,10	11:00 18:15	<u>7</u>			
42:4,10	11:27 44:9				
43:1	13(b)(5)	<u>8</u>			
Wednesday	29:10 32:21	85,000 29:17			
18:12 20:3	40:3				
45:6	140 26:14				
weed 29:17	16 28:12,17				
week 33:15	28:21,23,24				
weeks 35:22	30:9 31:5,9				
44:3	31:18 32:1				
willing 37:5	32:22 33:2				
witness 19:12	34:10 37:7				
21:23 24:10	37:7 38:12				
33:13 42:18	38:17,18				
witnesses	40:13				
22:4 23:13	18 18:8				
25:10 29:2					
33:14,14	<u>2</u>				
36:17 41:5	200 18:10				
41:9,10,14	19:9				
43:10	2017 18:12				
wondering	20:3 45:6				
21:8 34:23	202 18:25				
work 23:19	222(a) 35:10				
wouldn't	23rd 39:24				
22:21 23:24					
24:19	<u>3</u>				
	3-17950 18:4				
X	45:5				
	302s 42:10				
Y	30th 32:18				
Yeah 26:20	39 34:17				
years 36:12					
38:5,5	<u>4</u>				
York 18:11	400 18:10				
19:10,10,19	19:9				
19:19 21:2	45 19:18				
21:14 22:15	46 18:8				
22:16 24:3	467-9200				
24:4,9 26:7	18:25				
45:7	<u>5</u>				
Z	500 28:14				
	57 33:14				
0					
	<u>6</u>				
1	6 18:12 20:3				

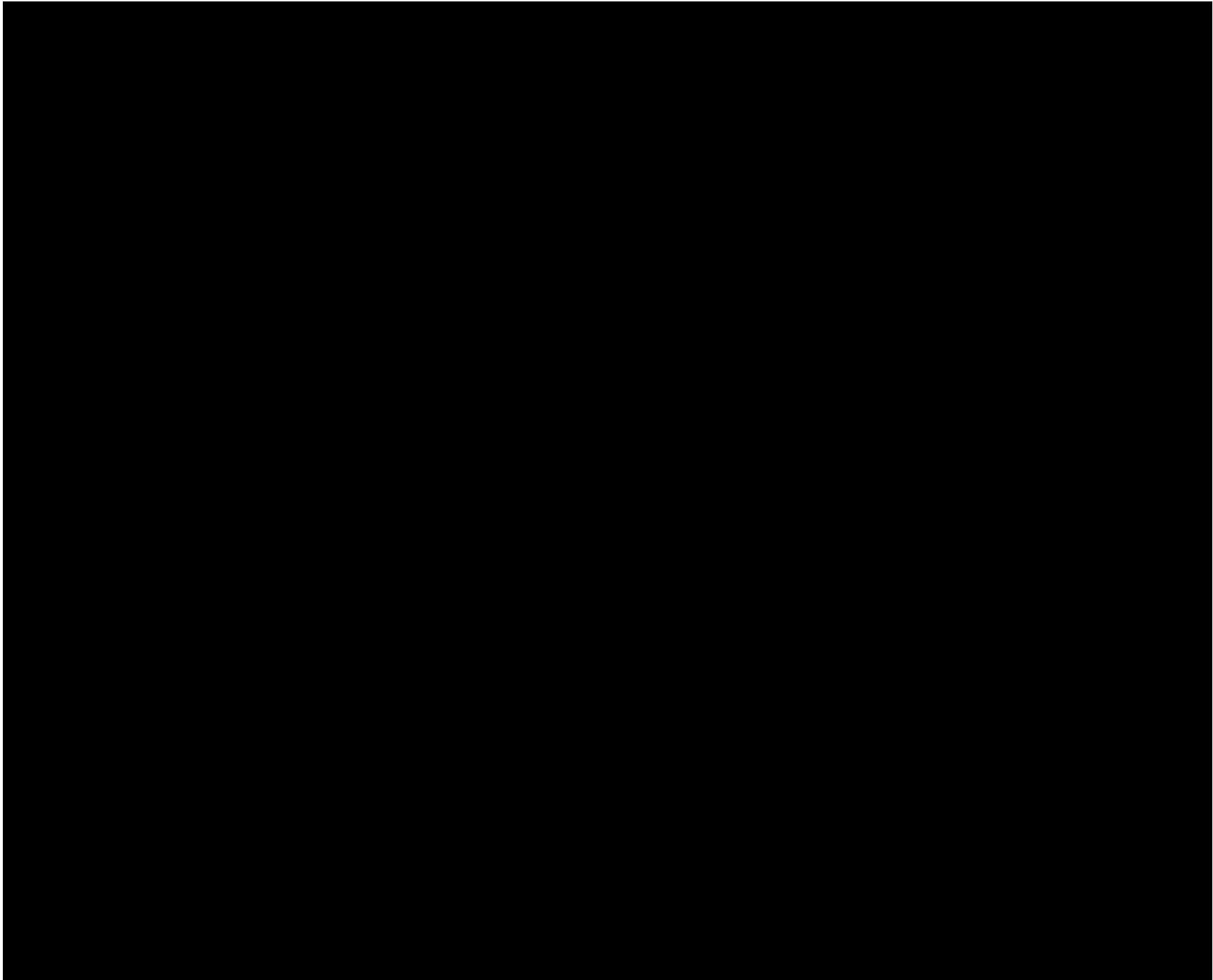
Exhibit B

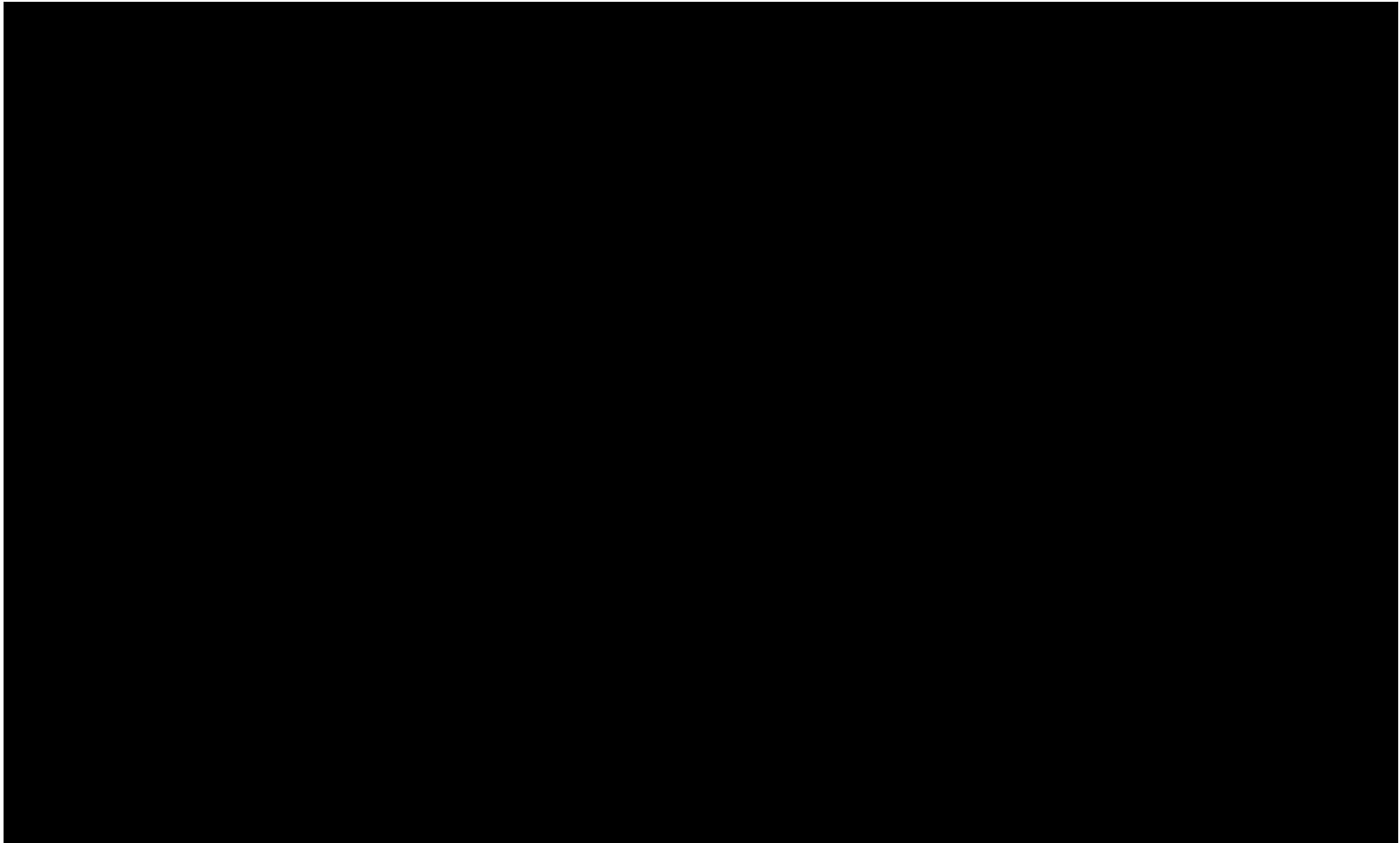


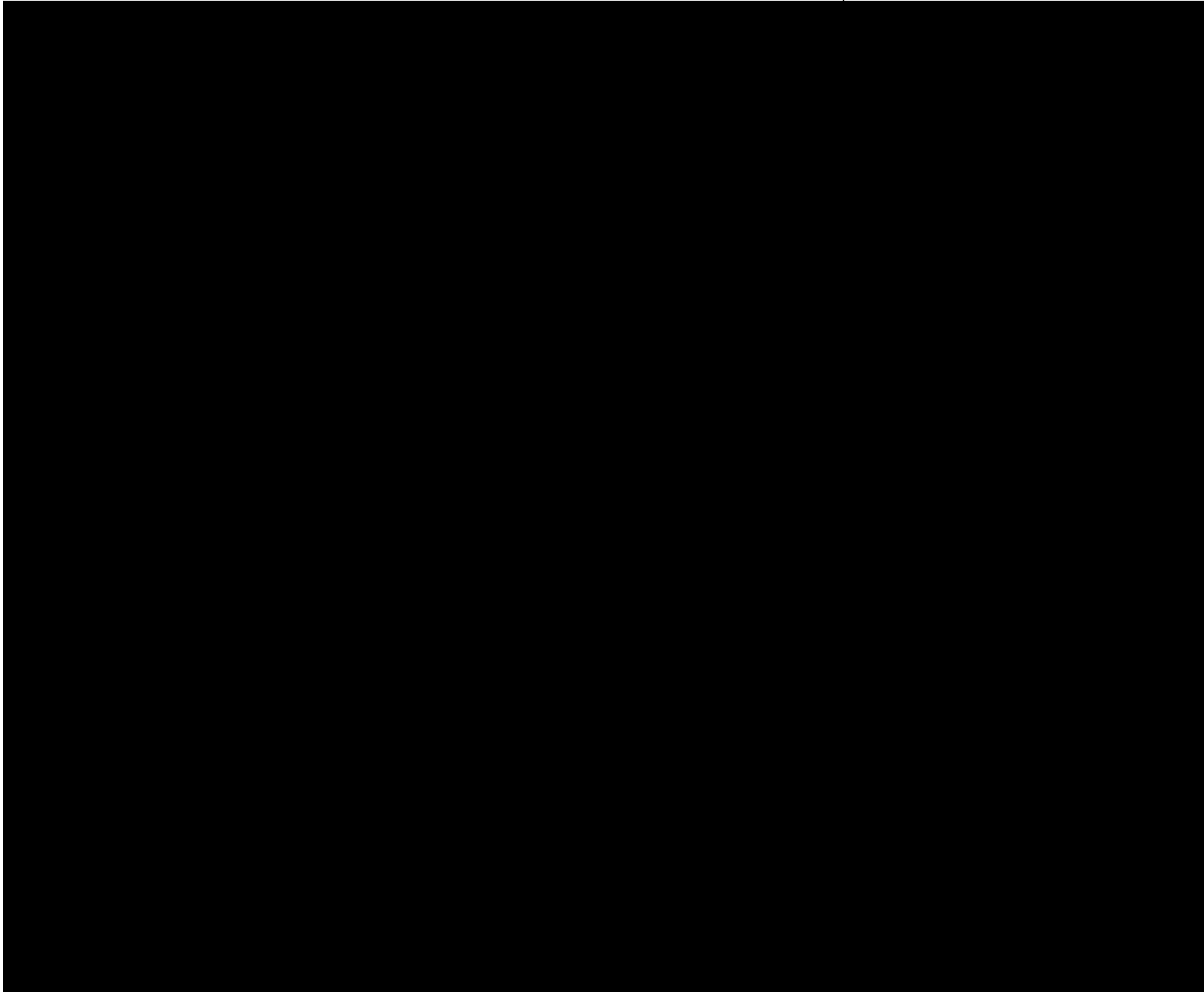


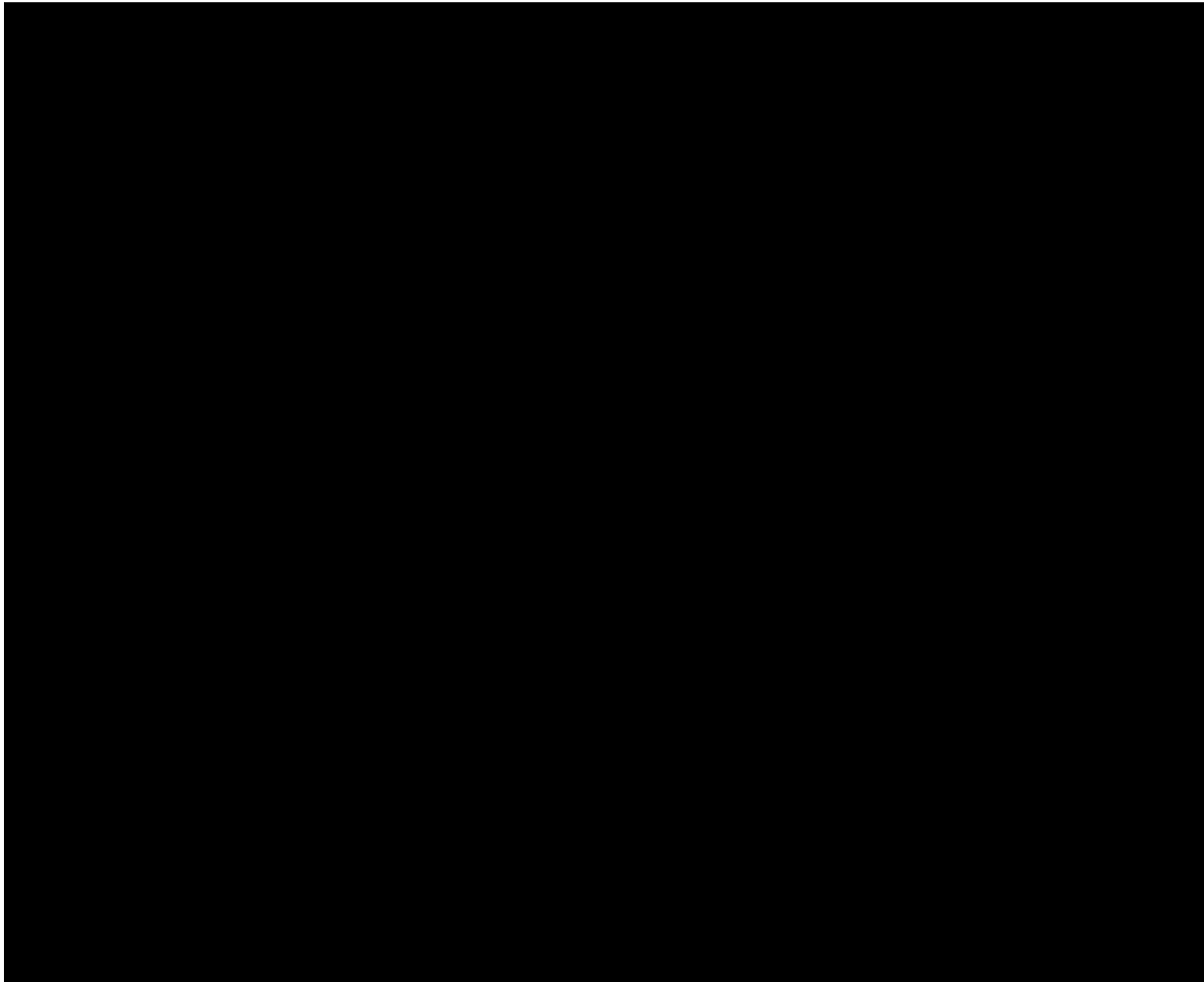


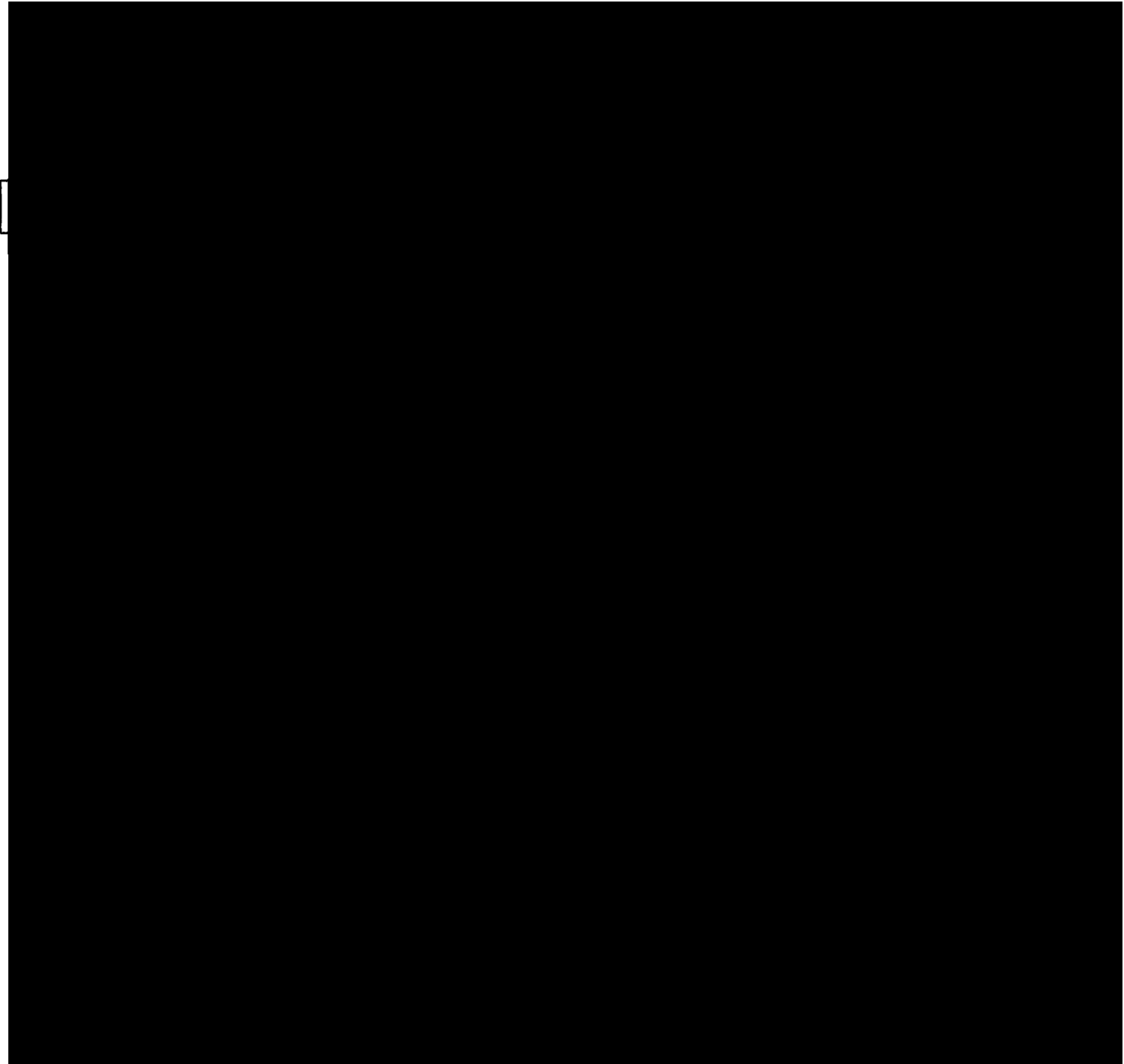




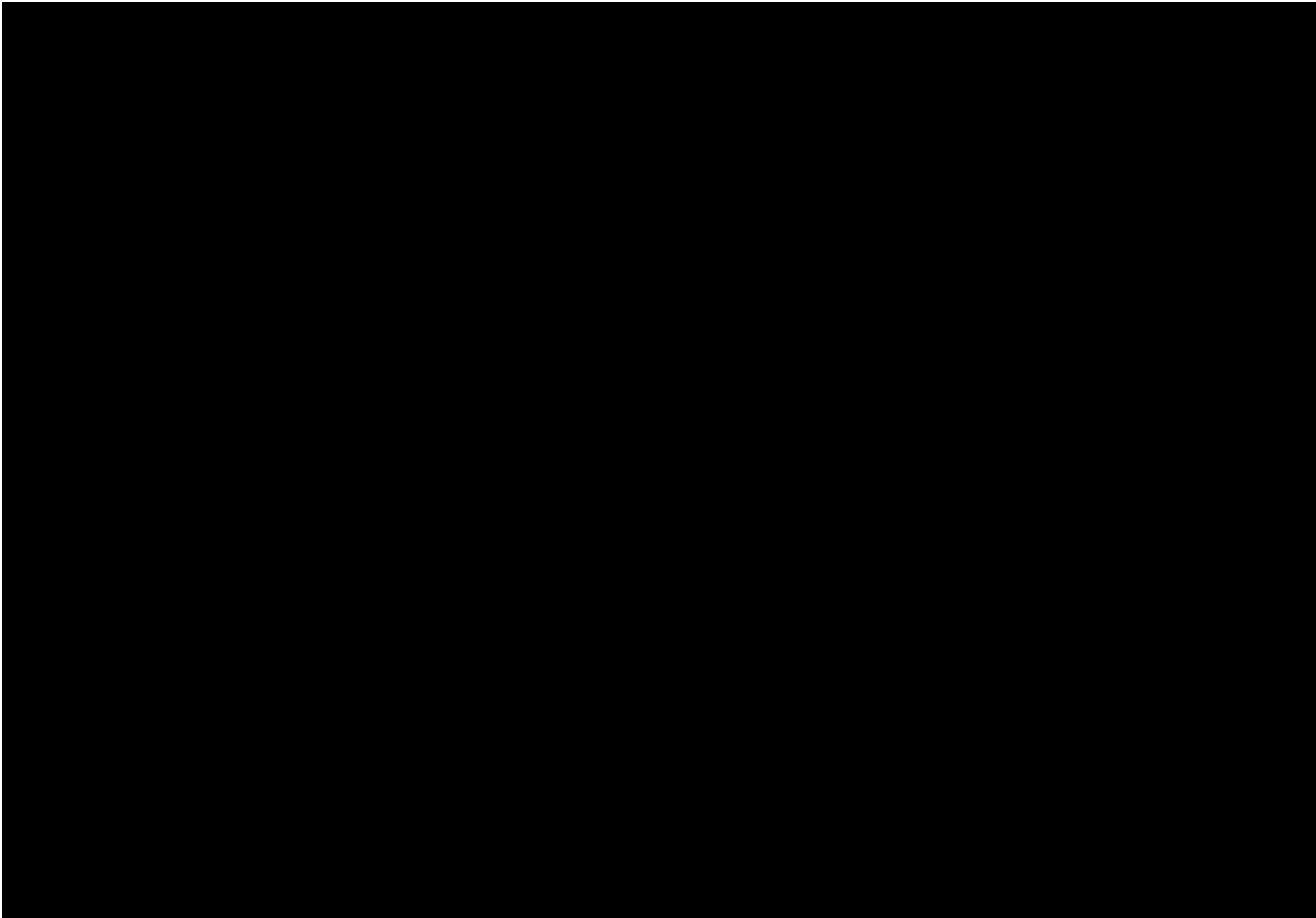


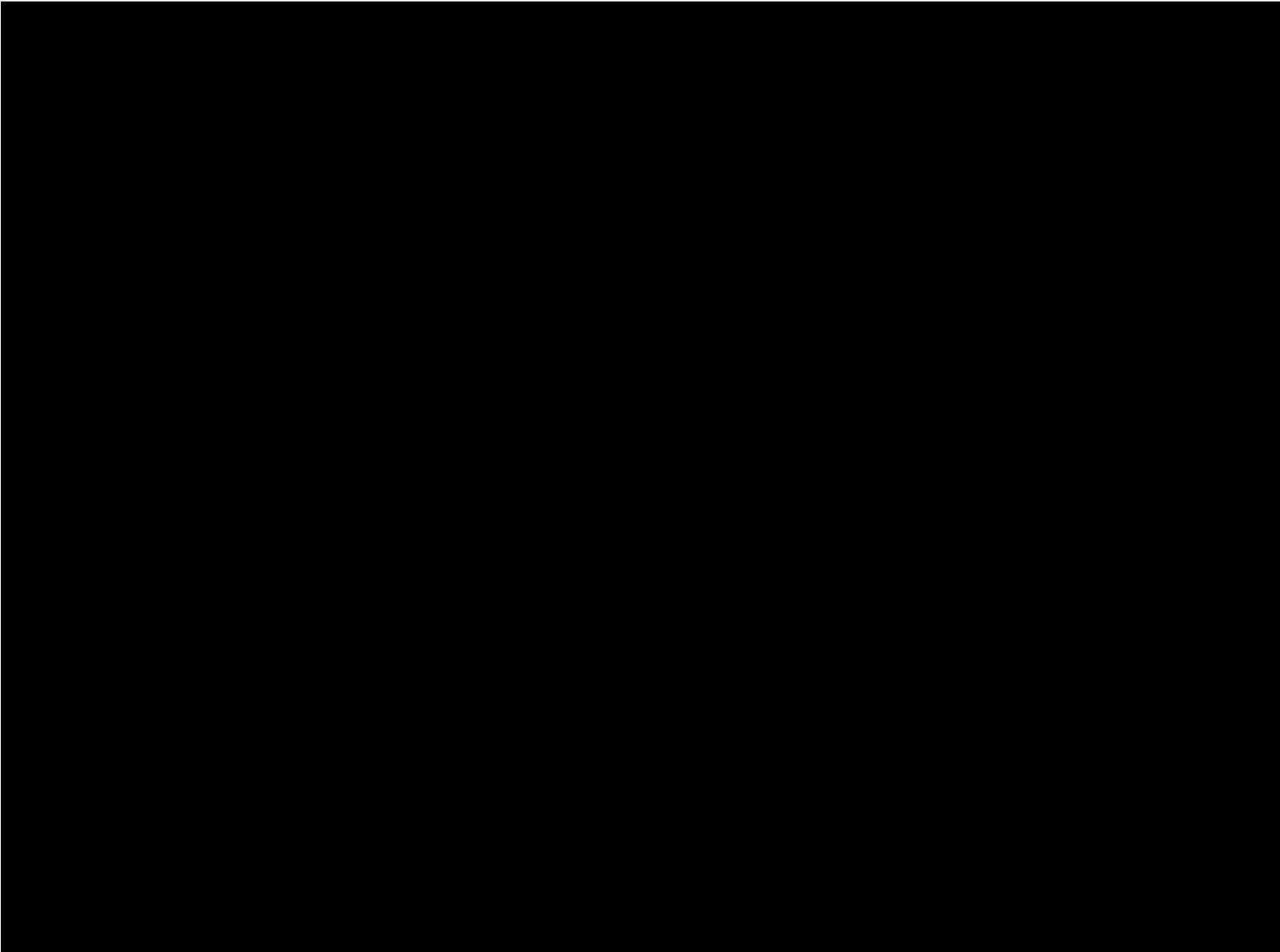


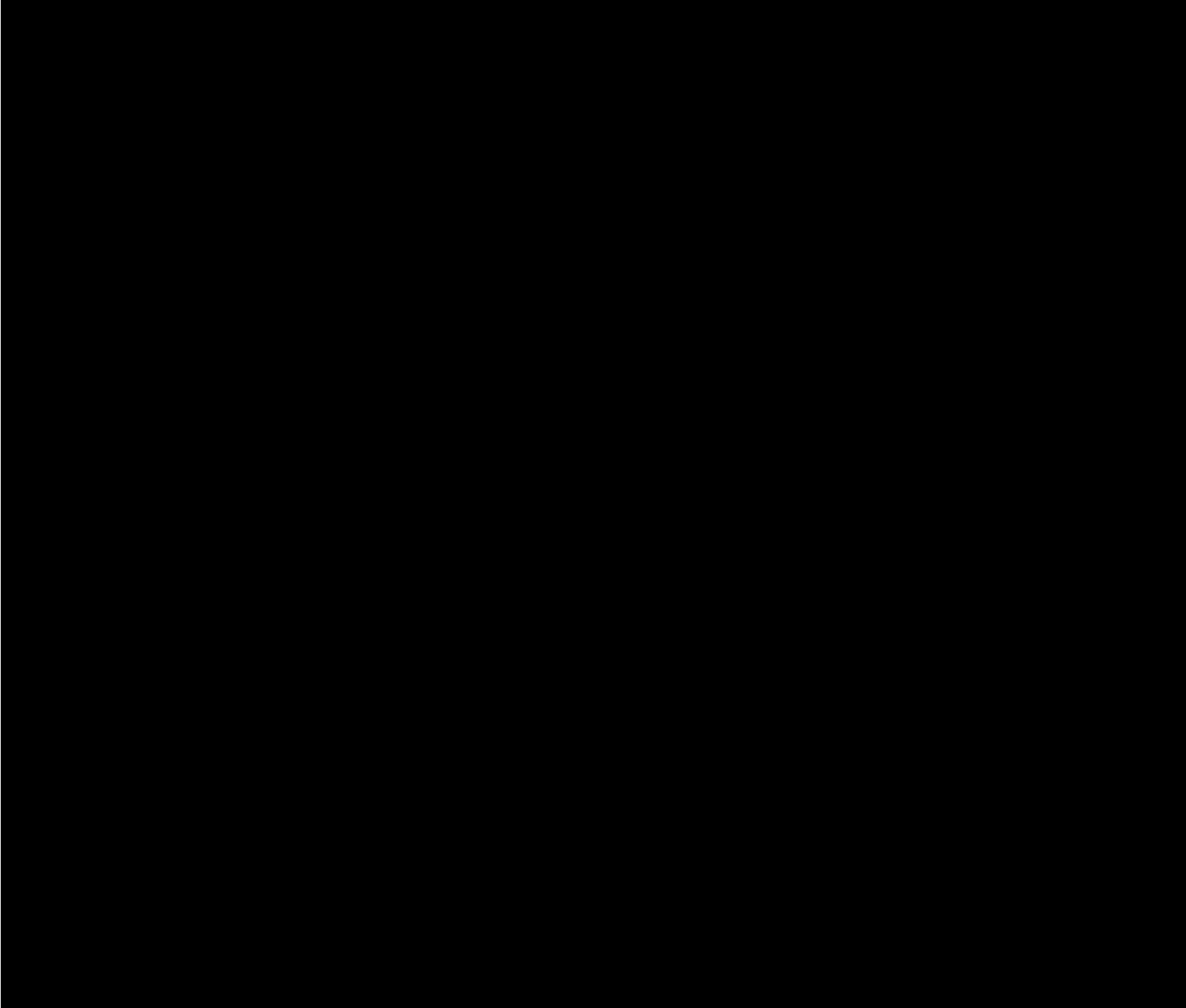


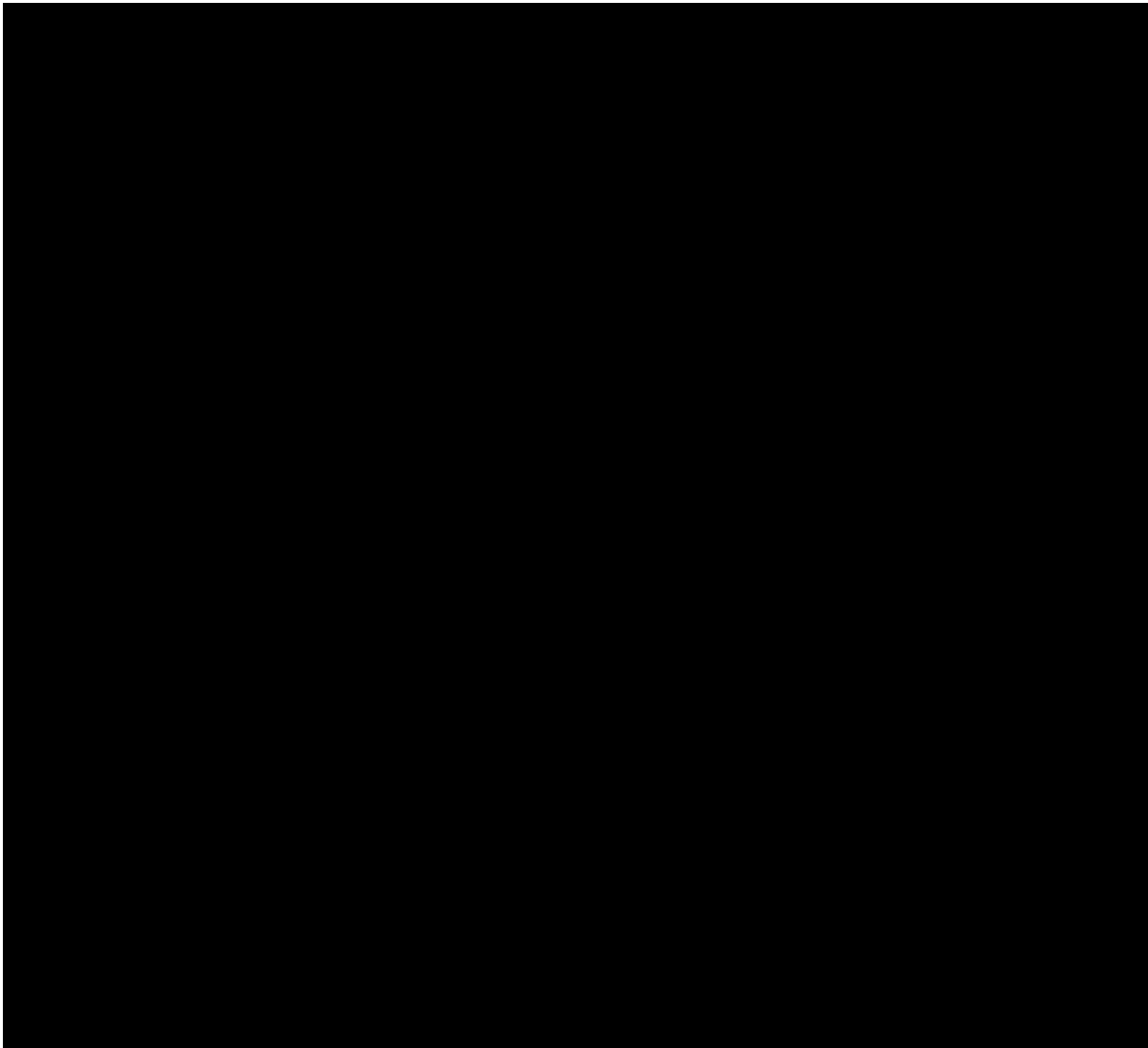












CERTIFICATE OF SERVICE

I hereby certify that I served the Division of Enforcement's September 20, 2017 Memorandum Following Prehearing Conference by mailing a copy of the same via e-mail, on this 20th day of September 2017, to Respondent:

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