UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
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January 19, 2018

VIA Fax and UPS

Honorable Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
200 F Street, NE
Washington, D.C. 20549-2557

Re: In the Matter of David Pruitt, CPA;
Admin. Proc. File No. 3-17950

Dear Mr. Fields:

Enclosed please find the original and three copies of: 1) the Division of Enforcement's January 19, 2018 Memorandum in Response to Respondent's Motion to Revise Prior Decisions and 2) the January 19, 2018 Declaration of H. Gregory Baker, Esq. with accompanying exhibits (the "Baker Declaration"). Pursuant to the Court's November 15, 2017 Protective Order, we are also enclosing three additional copies of the Baker Declaration that have been redacted to conceal the identity of certain L3 employees. The redacted versions are marked "Redacted – Subject to November 15, 2017 Protective Order."

Respectfully submitted,

David Oliwenstein
Senior Counsel
Division of Enforcement

Enclosures

cc: VIA EMAIL
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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17950

In the Matter of

David Pruitt, CPA

Respondent.

DIVISION OF ENFORCEMENT'S MEMORANDUM IN RESPONSE TO RESPONDENT'S MOTION TO REVISE PRIOR DECISIONS

The Division of Enforcement (the "Division") respectfully submits this memorandum in response to Respondent David Pruitt's January 5, 2018 Motion to Revise Prior Decisions Pursuant to the Court's December 11, 2017 Order (the "Motion").

BACKGROUND AND PRELIMINARY STATEMENT

On April 28, 2017, the Securities and Exchange Commission issued an order instituting proceedings (the "OIP") alleging that Respondent generated invoices in the internal accounting system of L3 Technologies, Inc. ("L3"), a major U.S. government contractor, in order to improperly recognize revenue. The OIP also provides that Respondent instructed his subordinates to disregard L3's internal controls regarding revenue recognition, which, among other things, require invoices to be delivered to the customer at the time they are generated.

The Division alleges 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 fail to maintain accurate books, records and accounts that in reasonable detail, accurately and

fairly reflect the transactions and dispositions of the assets of the company. The Division also alleges that Respondent violated Section 13(b)(5) of the Exchange Act by knowingly circumventing a system of internal accounting controls or knowingly falsifying L3's books, records or accounts.

On July 14, 2017, Respondent moved for a ruling on the pleadings pursuant to Rule of Practice 250(a) (the "Rule 250 Motion"). In his Rule 250 Motion, Respondent argued that the books and records charges should be dismissed because the dollar amounts at issue were *de minimis* to L3's overall revenue and that L3's internal accounting controls did not require the delivery of invoices. In a decision that carefully examined the plain text, legislative history, and Congressional intent (as well as the Commission's intent) behind the books and records provisions of the Exchange Act, the Court rejected Respondent's arguments, and held that the *de minimis* exception that Respondent sought to invoke "is not a free pass to intentionally misrecognize just a little bit of revenue." Order Denying Motion for Ruling on the Pleadings, Admin. Proc. Rulings Release No. 4937, *In the Matter of David Pruitt, CPA*, Admin. Proc. File No. 3-17950, at 4 (Aug. 1 2017) (the "Rule 250 Order"). The Court also rejected Respondent's arguments regarding the internal controls charges, and held that "[v]iewed in the light most favorable to the Division, IR [Invoicing and Receivables] 4 requires delivery of an invoice to a customer at the same time the invoice is generated and the transaction that is the invoice's subject recorded." *Id.* at 6.

In bringing his current Motion, Respondent largely recycles the same arguments that the Court already considered, but asks the Court to reach the opposite conclusion. The Court should decline Respondent's invitation and ratify its prior decision.

The Court should also deny Respondent's request that the Court revise its order directing

the Division to submit a list of the internal control or controls that are relevant to Respondent's alleged violation of Exchange Act Section 13(b)(5). *See* Motion at 15-16. Respondent's sole argument in support of his request is that the Court "denied Respondent the opportunity to be heard on this issue." *See Id.* at 16. But that assertion is not correct. During the September 6, 2017 Prehearing Conference, Respondent explicitly consented to the inclusion of the 16 controls referenced as part of the Section 13(b)(5) charge. The Commission's November 30, 2017 ratification order allows parties to "submit any new evidence the parties deem relevant," but it is not an invitation for a Respondent to take inconsistent positions, particularly where, as here, the parties engaged in substantial (and costly) expert discovery in reliance on Respondent's initial position. Respondent's Motion should be denied in its entirety.

ARGUMENT

I. THE COURT CORRECTLY CONCLUDED THAT THE OIP IS ADEQUATELY PLED

In denying Respondent's Rule 250 Motion, the Court held that the OIP's allegations regarding both the books and records and internal controls violations were legally and factually sufficient. *See* Rule 250 Order at 3-6. The Court should ratify that decision.

As the Court has already concluded, Section 13(b)(2)(A)'s *de minimis* exception "provides a safe harbor for an issuer that 'records ... transactions in conformity with accepted methods of recording economic events,' ... not an issuer whose officers intentionally recognize revenue that they allegedly know should not be recognized." *Id.* at 4. In continuing to insist otherwise, Respondent fails to appreciate that in enacting Section 13(b)(2)(A), Congress rejected the quantitative standard for assessing reasonableness that Respondent urges the Court to adopt. *See, e.g.*, H.R. Rep. No. 100-576, at 917 (1988) (Conf. Rep.) ("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 . . . ."); *SEC v. World-Wide Coin Invs., Ltd.*, 567 F. Supp. 724, 749 (N.D. Ga. 1983) (noting that Congress rejected the view "that inaccuracies involving small dollar amounts would not be actionable" and finding that liability is "not limited to material transactions or to those above a specific dollar amount.").[1] As the Court previously concluded, the allegations in the OIP are more than sufficient to satisfy the reasonable detail requirement under Exchange Act Section 13(b)(2)(A). *See* Rule 250 Order at 3-4.

The Court should also deny Respondent's request that the Court revisit its decision denying Respondent's motion to dismiss the internal controls claim. As Respondent acknowledges, this Court has reviewed the allegations in the OIP as well as the text of L3's internal control IR 4, and concluded that "[v]iewed in the light most favorable to the Division, IR 4 requires delivery of an invoice to a customer at the same time the invoice is generated and the transaction that is the invoice's subject recorded." Rule 250 Order at 6. Rather than point to any flaw in the Court's analysis, Respondent asks the Court to revisit its prior holding on the basis that Respondent's expert has subsequently opined that IR 4 does not require delivery of an invoice to customers.[2] *See* Motion at 13. Respondent also asks the Court to ignore the well pled

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[1] In commenting on a predecessor bill to the Foreign Corrupt Practices Act, the Commission made clear that the books and records provisions should not "lead to the argument that falsifications or omissions below a certain dollar amount may be tolerated." Promotion of the Reliability of Financial Information, Exchange Act Release No. 13185, 1977 WL 174077, at *4 n.6 (Jan. 19, 1977).

[2] The Division's expert, Mary Karen Wills, the Leader of the Government Contract Advisory Practice at the Berkeley Research Group, LLC takes the opposite view, opining that "the delivery requirement in IR 4 is a crucial part of the control [because it] ensure[s] that the revenue L3 bills for is actually collectible as is required under SAB 104 ...." *See* November 3, 2017 Expert Report of Mary Karen Wills, CPA ¶ 141.

allegations in the OIP that Respondent knowingly directed the premature recognition of revenue and ordered a subordinate to withhold delivery of the invoices from the U.S. Army, OIP ¶¶ 2, 20, 22-25, and dismiss the internal controls charge based on an email from an L3 employee responsible for the contract with the U.S. Army (referred to as the C-12 Business Manager) memorializing a discussion that he had with Respondent. These arguments are inappropriate on a motion challenging the sufficiency of the OIP, and the Court should summarily reject them.[3] *See* 17 C.F.R. § 201.250(a) (2016) (On a motion for a ruling on the pleadings, the Court must "accept[] all of the non-movant's factual allegations as true and draw[] all reasonable inferences in the non-movant's favor."); *Adrian D. Beamish, CPA*, Admin. Proc. Rulings Release No. 4504, 2017 WL 1175585, at *1 (ALJ Jan. 6, 2017) (A motion for a ruling on the pleadings must be based only on the pleadings, matters subject to official notice, matters of public record, and documents attached to, or incorporated by reference in, the OIP or answer.).

Respondent has offered no basis for the Court to revise its order denying Respondent's motion for a ruling on the pleadings. The Court should affirm its prior decision denying Respondent's Rule 250 Motion.

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[3] Respondent's reliance on the January 11, 2014 Email from the C-12 Business Manager in support of his assertion that he directed the C-12 Business Manager to deliver the revenue recovery invoices is misplaced. *See* January 5, 2018 Affidavit of Bari R. Nadworny, Ex. A. In that email, the C-12 Business Manager memorializes a conversation in which Respondent instructed the C-12 Business Manager to ensure that their "story was consistent" for L3's auditor and asked whether the C-12 Business Manager had "gotten those **other** revenue recovery invoices out yet." *See id.* (emphasis added). But Respondent declined to inform the Court that the January 11, 2014 email refers to invoices that were generated on January 10 (*i.e.*, the exact day of the conversation memorialized in the email) – not the invoices that were generated at Respondent's direction on December 27, 2017. *See* January 19, 2018 Declaration of H. Gregory Baker ("Baker Decl.") Ex. A. Moreover, Respondent has admitted in testimony that the January 10, 2014 discussion with the C-12 Business Manager was unrelated to the invoices that were generated at Respondent's direction. *See* Baker Decl. Ex. B. ("It's probably referring to the [invoices] that [the C-12 Business Manager] was doing with Gordon [Walsh][the President of the immediate corporate parent of the division for which Respondent served as principal financial officer].").

II. THE COURT SHOULD REJECT RESPONDENT'S ATTEMPT TO NARROW THE SCOPE OF THE INTERNAL CONTROLS CHARGE

As he has previously argued, Respondent contends that the internal controls charge should be limited to Respondent's direction to withhold invoices from the United States Army. *See* Motion at 15-16. As discussed in extensive detail in the Division's September 20, 2017 Memorandum in Response to the Court's September 6, 2017 Order Following Prehearing Conference (the "Internal Controls Memorandum"), each of the 16 controls identified in the Division's June 30, 2017 letter is supported by substantial facts alleged in the OIP. Tellingly, Respondent has not challenged the factual basis for the alleged violation of any of those controls with specificity – with the exception of IR 4 – either in response to the Division's Internal Controls Memorandum or in his current Motion. Instead, Respondent asserts that the Court "denied Respondent the opportunity to be heard on the issue." *See* Motion at 16.

Respondent's claim is without merit. On September 6, 2017, the Court conducted a prehearing conference and heard arguments regarding the scope of the internal controls charge. During that conference, the Court asked Respondent "if we were to ... just consider the 16 internal controls as the entire universe of internal controls ... then that would satisfy your concerns; is that correct?" *See* Baker Decl. Ex. C. Respondent replied "[y]es, your Honor" and indicated that it would enable him to formulate his defenses. *See Id.*

The extensive detail in the Division's Internal Controls Memorandum has mooted Respondent's apparent concerns that he will be unable to "adequately prepare a defense and avoid trial by ambush." *See, e.g.*, Respondent's June 16, 2017 Reply Memorandum of Law in Support of his Motion for a More Definite Statement at 1. Based on the factual allegations in the OIP and the Internal Controls Memorandum, Respondent's expert had sufficient information to opine regarding the requirements of each control and whether Respondent circumvented them.

See November 3, 2017 Expert Report of John Riley, CPA ¶¶ 112-31.

Respondent cannot plausibly claim that he was prejudiced by having to defend against a charge that includes the 15 internal controls that the Division has alleged as part of the Section 13(b)(5) charge.[4] The Division's June 30, 2017 letter amended the OIP to include those controls in the initial stages of this proceeding. *Contra ABC Rug & Carpet Cleaning Serv., Inc. v. ABC Rug Cleaners, Inc.*, No. 08 Civ. 5737 (RMB) (RLE), 2009 WL 773256 at *4 (S.D.N.Y. Mar. 23, 2009) ("Where discovery has been closed, subsequent amendment to the pleadings may be prejudicial to the opposing party."). Although Respondent would prefer to defend against an internal controls charge that is premised on only one control, Respondent should not be permitted to shift his position now that document discovery is nearly complete and the parties have expended significant resources (including preparing expert reports) to litigate the internal controls charge. By contrast, the Division will be substantially prejudiced if it is forced to prosecute this action without being able to present the Court with evidence regarding all of the internal accounting controls that Respondent knowingly circumvented.

[4] Although the Division initially identified16 relevant internal accounting controls, in an effort to narrow the disputes for trial, the Division voluntarily eliminated one of those controls – IR 6 – from the scope of the Section 13(b)(5) charge against Respondent. In accordance with the Court's 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* Order Following Prehearing Conference, Admin. Proc. Rulings Release No. 5024, *In the Matter of David Pruitt, CPA*, Admin. Proc. File No. 3-17950.

CONCLUSION

For the foregoing reasons, the Division respectfully requests that Respondent's motion to revise prior decisions be denied and that the Court affirm all prior decisions in this proceeding.

Dated: January 19, 2018
New York, New York

DIVISION OF ENFORCEMENT

By: _____

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CERTIFICATE OF SERVICE

I hereby certify that I served the Division of Enforcement's January 19, 2018 Memorandum in Response to Respondent's Motion to Revise Prior Decisions by mailing a copy of the same via e-mail, on this 19th day of January 2018, to Respondent:

David Pruitt
c/o John J. Carney, Esq.
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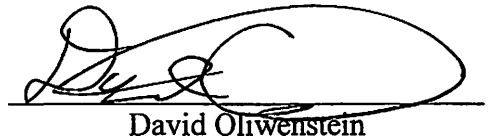

David Oliwenstein