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 TO REVISE PRIOR DECISIONS PURSUANT TO THE COURT'S DECEMBER 11, 2017 ORDER

Once again, the Division misses the mark and would have this Court apply a standard that does not exist in Section 13 of the Exchange Act[1] in order to support the legally deficient and factually unsupported allegations in the OIP.[2] Respondent David N. Pruitt respectfully submits this reply memorandum to address two critical areas in which the Division misstates the law and selectively restates the record: (1) the meaning of "reasonable detail" and the application of the *de minimis* exemption in Section 13(b)(2)(A); and (2) the Division's futile quest to salvage its deficient internal controls allegations. The Court should revise its prior rulings and grant Respondent's motion for a ruling on the pleadings.

[1] References to Section 13 of the Exchange Act, or subsections thereof, refer to Section 13 of the Securities Exchange Act of 1934, 15 U.S.C. § 78m, or the corresponding subsections thereof.
[2] The Division offers no explanation for the allegations in the OIP it now knows are factually and demonstrably incorrect. *See* Memorandum of Points and Authorities in Support of Respondent David Pruitt's Motion to Revise Prior Decisions Pursuant to the Court's December 11, 2017 Order, *In the Matter of David Pruitt, CPA*, Admin. Proc. File No. 3-17950, at 2 n.6 (Jan. 5, 2018).

I. THE PRUDENT OFFICIALS STANDARD IS AN OBJECTIVE STANDARD

The Division disregards the fact that "in reasonable detail" was added to Section 13(b)(2)(A) so that *de minimis* discrepancies would not render a company's books and records inaccurate. The "reasonable detail" language was intended to make clear that issuers are not required to maintain books and records with absolute precision and that *de minimis* errors or misstatements, regardless of their cause (intentional or innocent), do not violate the statute. There is simply no mention or suggestion of any intent requirement in the statutory text because Congress did not create a standard that would require the Court to delve into an employee's subjective state of mind to determine whether an issuer's books and records were maintained in reasonable detail.

The only relevant test is whether the books and records were maintained in "such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs."[3] This objective test does not ask whether Respondent acted as a prudent official or whether he intended to do what he did. Rather, the test inquires whether objectively prudent officials in the conduct of their own affairs would be satisfied with the level of detail in which the books and records were maintained, even where the records include a purported "intentional" misstatement that amounts to 14/100th of one percent of revenue. The Division does not argue, because it cannot credibly do so, that reasonably prudent officials in the conduct of their affairs would view such a miniscule misstatement as causing books and records to not be kept in the

[3] Exchange Act Section 13(b)(7). The Division continues to rely on *SEC v. World-Wide Coin Invs., Ltd.*, 567 F. Supp. 724 (N.D. Ga. 1983). Not only does this case not address the relevant standard, but it was also decided years before Congress enacted the current version of Section 13(b)(7). The Division's blind reliance on this dubious precedent is indicative of its desire to substitute its own intent for that of Congress and write the law as it wishes it was written instead of how it actually is.

reasonable detail required by Section 13. This alone is sufficient for the Court to dismiss the books and records portion of the OIP.

The Court has previously stated that the *de minimis* exemption provides a safe harbor for an issuer that "records [its] transactions in conformity with accepted methods of recording economic events."[4] Limiting the safe harbor to situations where the transactions at issue were recorded in conformity with accepted methods of recording economic events would render the *de minimis* exemption meaningless since the issuer's books and records would in that case be accurate. The term "reasonable detail" contemplates a safe harbor for *de minimis* transactions that an issuer has *not* recorded in such a manner and because the resulting misstatement is so miniscule, it does not violate the objective "reasonable detail" standard. This is the precise purpose of the *de minimis* exemption—to prevent miniscule misstatements from violating Section 13(b)(2)(A). A contrary conclusion would not be in accordance with the plain language of the provision and the intent of Congress when it added the "in reasonable detail" qualification to the statute. The alleged revenue misstatement at issue in this proceeding is exactly the type of *de minimis* misstatement Congress did not intend to be actionable under Section 13(b)(2)(A).

II. THE INTERNAL CONTROLS CHARGE SHOULD BE DISMISSED

The Division cites selectively from the transcript of the September 6, 2017 telephonic prehearing conference and ignores the fact that it is the Division's own deficient pleadings on internal controls that caused protracted motion practice here and requires dismissal. The OIP states plainly that "[t]he invoices had not been delivered to the U.S. Army, in violation of a specific internal control of L3 that required delivery of invoices."[5] Despite this statement, at

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[4] *See* Order Denying Motion for Ruling on 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) (quoting H.R. REP. No. 95-831, at 10 (1977) (Conf. Rep.)).

[5] OIP ¶ 39.

every opportunity in this proceeding, the Division has sought to expand its internal controls allegations beyond this single allegation in the OIP.[6] As the Division well knows, these ever-evolving internal controls allegations caused Respondent to file a motion to compel the Division to comply with the Court's June 23, 2017 order.[7] The relief Respondent sought through his motion to compel, discussed at length during the September 6 conference, was to once and for all limit the Division to a finite list of controls so that it could not surprise Respondent and randomly add controls it believed were circumvented on the eve of trial. Respondent never "consented" to the list of 16—later reduced to 15—internal controls set forth by the Division. The language from the prehearing conference cited by the Division in its opposition brief mischaracterizes the purpose of the motion to compel, which was to prevent the Division from engaging in trial by ambush on the internal controls charge. The motion to compel did not and was never intended to address the appropriateness of including the Division's additional controls. The Court's order requiring the Division to show cause before adding more controls resolved the motion to compel but in no way addressed the propriety of the Division's additions to the OIP.

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[6] *See, e.g.*, Division of Enforcement's Opposition to Respondent's Motion for a More Definite Statement, *In the Matter of David Pruitt, CPA*, Admin Proc. File No. 3-17950, at 6 (June 13, 2017) (listing three internal controls "among others" Respondent allegedly circumvented); Letter from Paul G. Gizzi to John J. Carney pursuant to the June 23, 2017 order dated June 30, 2017 (listing 16 internal controls relevant to the Section 13(b)(5) charge); Memorandum of Law in Opposition to Respondent's Motion for a Ruling on the Pleadings, *In the Matter of David Pruitt, CPA*, Admin Proc. File No. 3-17950, at 17 (July 21, 2017) (claiming Respondent circumvented an unspecified "system of internal accounting controls").

[7] Respondent David Pruitt'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). The Court's June 23, 2017 order required the Division to submit "[a] list of the internal control or controls that it asserts are relevant to the alleged violation of Exchange Act Section 13(b)(5)." 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 5 (June 23, 2017).

In portions of the prehearing conference the Division conveniently left out of its opposition brief, Respondent's counsel made clear that the Division's list of internal controls was "excessive," with many of the controls only "tangentially related to the facts at issue."[8] The Division should not be permitted to proceed with the laundry list of irrelevant controls that goes far beyond the single internal controls allegation in the OIP.

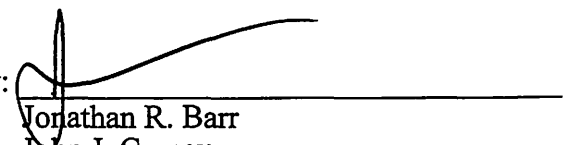
Additionally, the Division now claims prejudice and the burden of the costs incurred in preparing for a hearing based on its grossly expanded list of inapplicable controls. To the extent there is any burden, it was created entirely by the Division when it added 14 irrelevant controls to its facially deficient OIP. It would be far less burdensome for the parties to prepare for a hearing on the single control that the Division specifically alleged. In light of the incalculable harm done to Respondent's reputation and good name by the unfounded charges in the OIP, the Division can hardly complain of prejudice by being limited to the sole internal controls allegation it asserted after three years of investigation. Moreover, the single internal control the Division specifically alleged—IR 4—does not require delivery of an invoice to a customer. As such, the internal controls portion of the OIP should be dismissed.

[8] *See* Exhibit A to the Declaration of H. Gregory Baker, Esq. in Support of the Division of Enforcement's Memorandum Following Prehearing Conference, *In the Matter of David Pruitt, CPA*, Admin Proc. File No. 3-17950, at 28:17-29:2, 30:7-13, 38:16-23 (Sept. 20, 2017).

CONCLUSION

For the reasons set forth herein, the Court should grant Mr. Pruitt's Motion to Revise Prior Decisions Pursuant to the Court's December 11, 2017 Order.

Dated: January 23, 2018
New York, New York

By: 

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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 23rd day of January, 2018, I caused to be served a true copy of Reply Memorandum in Further Support of Respondent David Pruitt's Motion to Revise Prior Decisions Pursuant to the Court's December 11, 2017 Order via electronic mail upon the following parties and other persons entitled to notice:

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