

# 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.<sup>1</sup>

**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

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<sup>1</sup> 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.<sup>2</sup> 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.<sup>3</sup>

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.<sup>4</sup> 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

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<sup>2</sup> 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”).

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

<sup>4</sup> 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).<sup>5</sup> 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

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<sup>5</sup> 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,”<sup>6</sup> 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.<sup>7</sup>

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

FR 4A (Revenue Recognition Evaluation) requires that the Army Sustainment Division’s (“ASD”)<sup>8</sup> 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....)”.

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<sup>6</sup> 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.

<sup>7</sup> 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.*

<sup>8</sup> 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 Contract<sup>9</sup> while the contract was in effect as he was required to do. OIP ¶ 17. Respondent falsely represented to the Aerospace Systems<sup>10</sup> 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

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<sup>9</sup> 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.

<sup>10</sup> 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 OLIVENSTEIN  
Attorneys for the Division of Enforcement  
Securities and Exchange Commission  
200 Vesey Street, Suite 400  
New York, NY 10281

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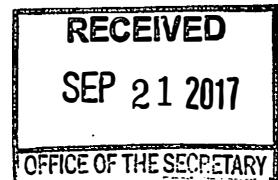
UNITED STATES OF AMERICA  
Before the  
**SECURITIES AND EXCHANGE COMMISSION**

**ADMINISTRATIVE PROCEEDING**  
File No. 3-17950

**In the Matter of,**

**David Pruitt, CPA,**

**Respondent.**



**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.



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

1 APPEARANCES  
 2  
 3 On behalf of the Securities and Exchange Commission:  
 4 DAVID OLIWENSTEIN, ESQ.  
 5 H. GREGORY BAKER, ESQ.  
 6 PAUL GIZZI, ESQ.  
 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. NADWORNY, ESQ.  
 17 Baker & Hostetler, LLP  
 18 45 Rockefeller Plaza  
 19 New York, New York 10111  
 20  
 21  
 22  
 23  
 24  
 25

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 Nadworny.  
 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

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

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?

<p style="text-align: center;">Page 23</p> <p>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.</p> <p>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.</p> <p>14           JUDGE GRIMES: I understand.</p> <p>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.</p> <p>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</p>	<p style="text-align: center;">Page 25</p> <p>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.</p> <p>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.)</p> <p>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.</p> <p>25           MR. GIZZI: Your Honor, this is Paul Gizzi</p>
<p style="text-align: center;">Page 24</p> <p>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?</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>24           MR. FOKAS: Yes, that's correct, your      25      Honor.</p>	<p style="text-align: center;">Page 26</p> <p>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.</p> <p>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.</p> <p>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?</p> <p>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.</p> <p>18           JUDGE GRIMES: I was more getting at the      19      facilities and the courtroom they would have there.</p> <p>20           MR. OLIVENSTEIN: 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.</p> <p>25           JUDGE GRIMES: All right. Well, I</p>

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.  
 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 parrotting 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

Page 31	Page 33
<p>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.</p> <p>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.</p> <p>14 But that — that's where we stand, your      15 Honor.</p> <p>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.</p> <p>21 Mr. Fokas, did you not take it that way?</p> <p>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</p>	<p>1 our position. As your Honor correctly pointed out, a      2 system of internal controls is the 16 controls that      3 we have identified.</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>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</p>
Page 32	Page 34
<p>1 those 16 internal controls constituted a — the      2 entire system.</p> <p>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.</p> <p>7 JUDGE GRIMES: Okay. Well, thank you.</p> <p>8 Who — who wants to address this issue for      9 the Division?</p> <p>10 MR. OLIVENSTEIN: Your Honor, this is David      11 Oliwenstein, and I'm going to address this issue on      12 behalf of the Division.</p> <p>13 JUDGE GRIMES: All right. Go ahead.</p> <p>14 MR. OLIVENSTEIN: 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.</p> <p>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</p>	<p>1 rely on those controls as well.</p> <p>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.</p> <p>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.</p> <p>12 JUDGE GRIMES: Well, I — I guess I have      13 few questions.</p> <p>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.</p> <p>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.</p> <p>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.</p>

<p style="text-align: center;">Page 35</p> <p>1           MR. OLIWENSTEIN: I think that there are a 2       lot of facts in the OIP that are relevant to this 3       charge.</p> <p>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 –</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>23      MR. OLIWENSTEIN: We – we're happy to do 24      that, your Honor.</p> <p>25      JUDGE GRIMES: All right. And thank you.</p>	<p style="text-align: center;">Page 37</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>25      And so, again, I think we strenuously</p>
<p style="text-align: center;">Page 36</p> <p>1       All right. Do you have anything else you'd 2       like to add before I turn back to Mr. Fokas?</p> <p>3       MR. OLIWENSTEIN: Not at this time, your 4       Honor.</p> <p>5       JUDGE GRIMES: All right. Mr. Fokas, 6       what – what are your thoughts?</p> <p>7       MR. FOKAS: Thank you, your Honor.</p> <p>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</p>	<p style="text-align: center;">Page 38</p> <p>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.</p> <p>9       And so I think, you know, that – that's, 10      again, where we are at this point.</p> <p>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?</p> <p>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.</p> <p>24      JUDGE GRIMES: All right. Any last 25      thoughts from the Division?</p>

<p style="text-align: center;">Page 39</p> <p>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</p>	<p style="text-align: center;">Page 41</p> <p>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</p>
<p style="text-align: center;">Page 40</p> <p>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?</p>	<p style="text-align: center;">Page 42</p> <p>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</p>

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)

20

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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.)

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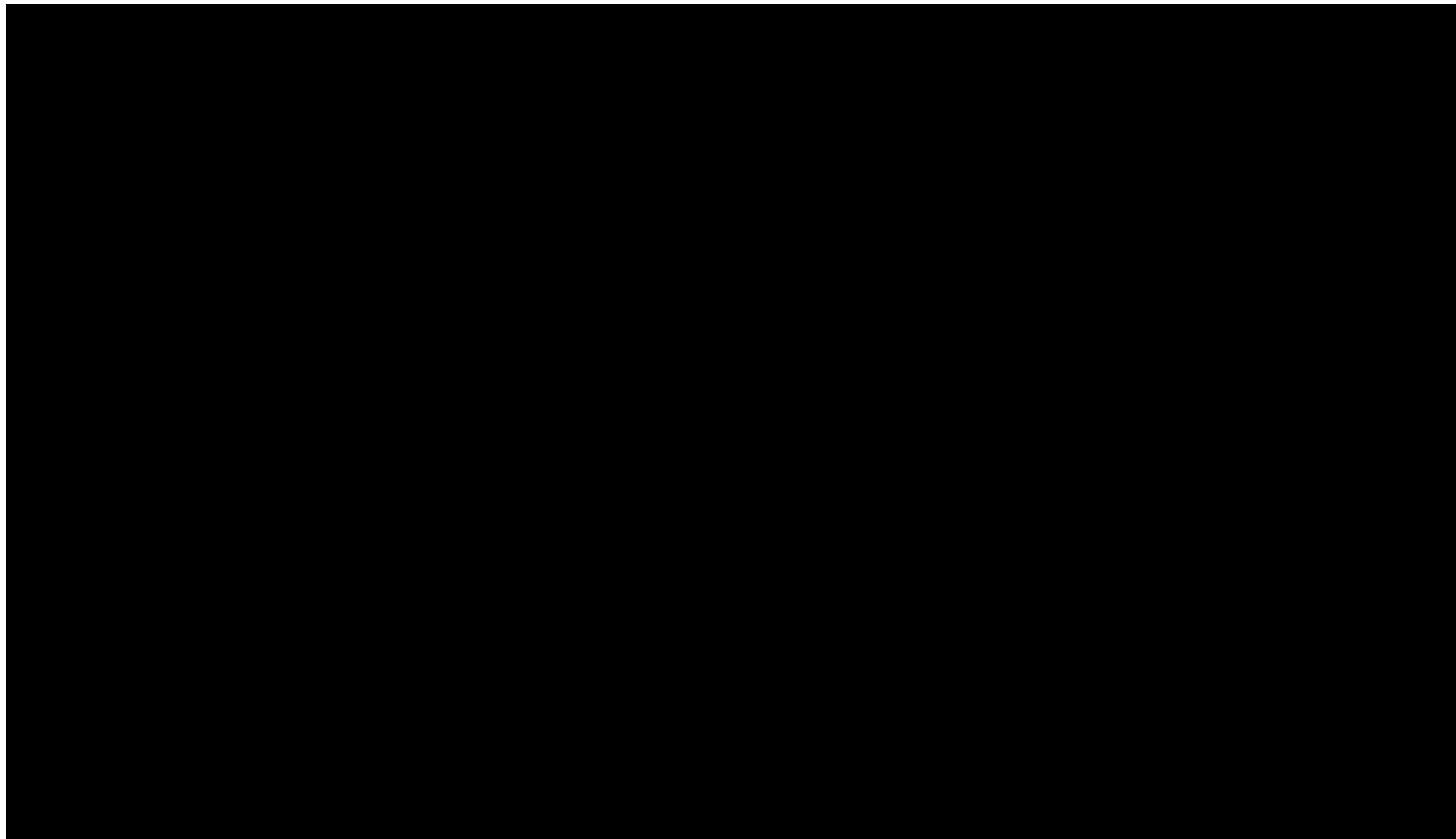
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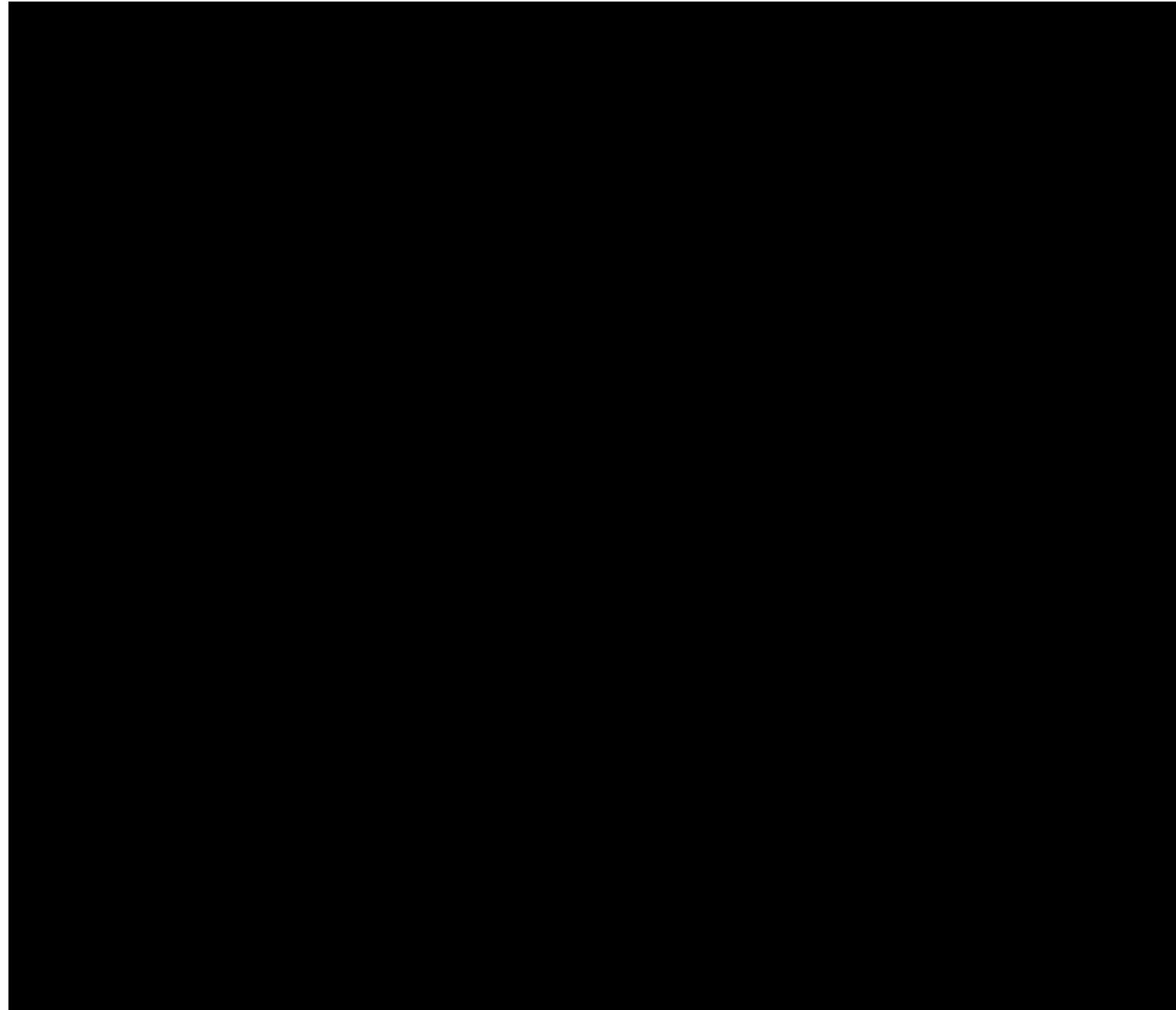
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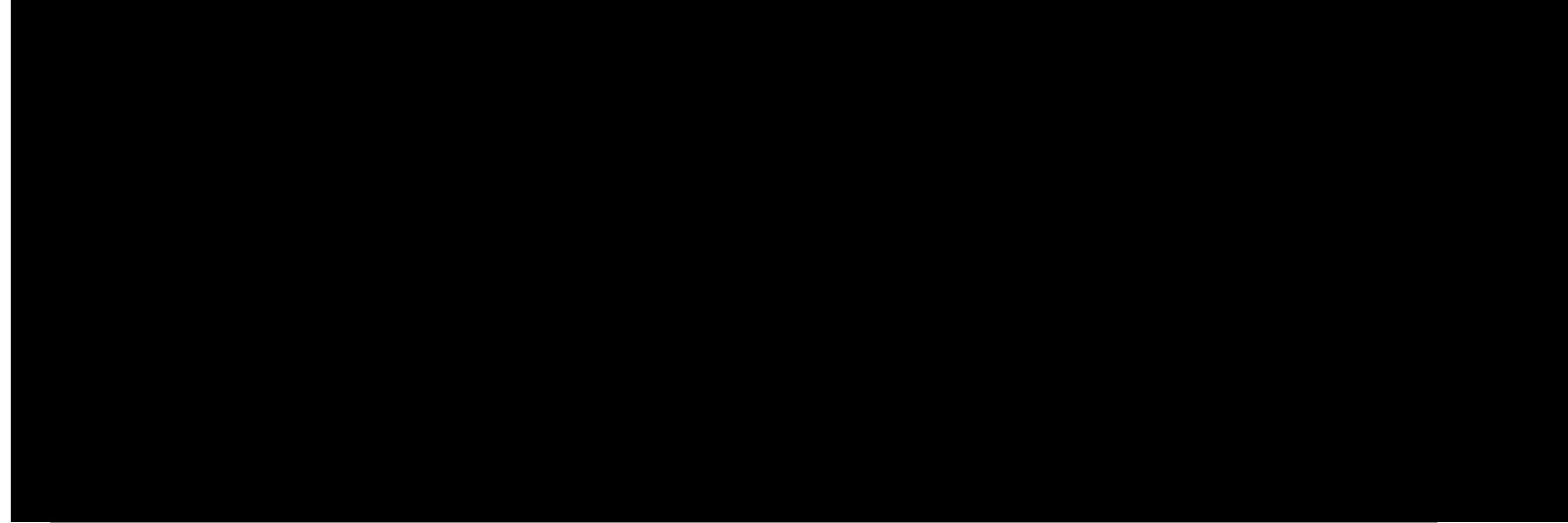
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# **Exhibit B**



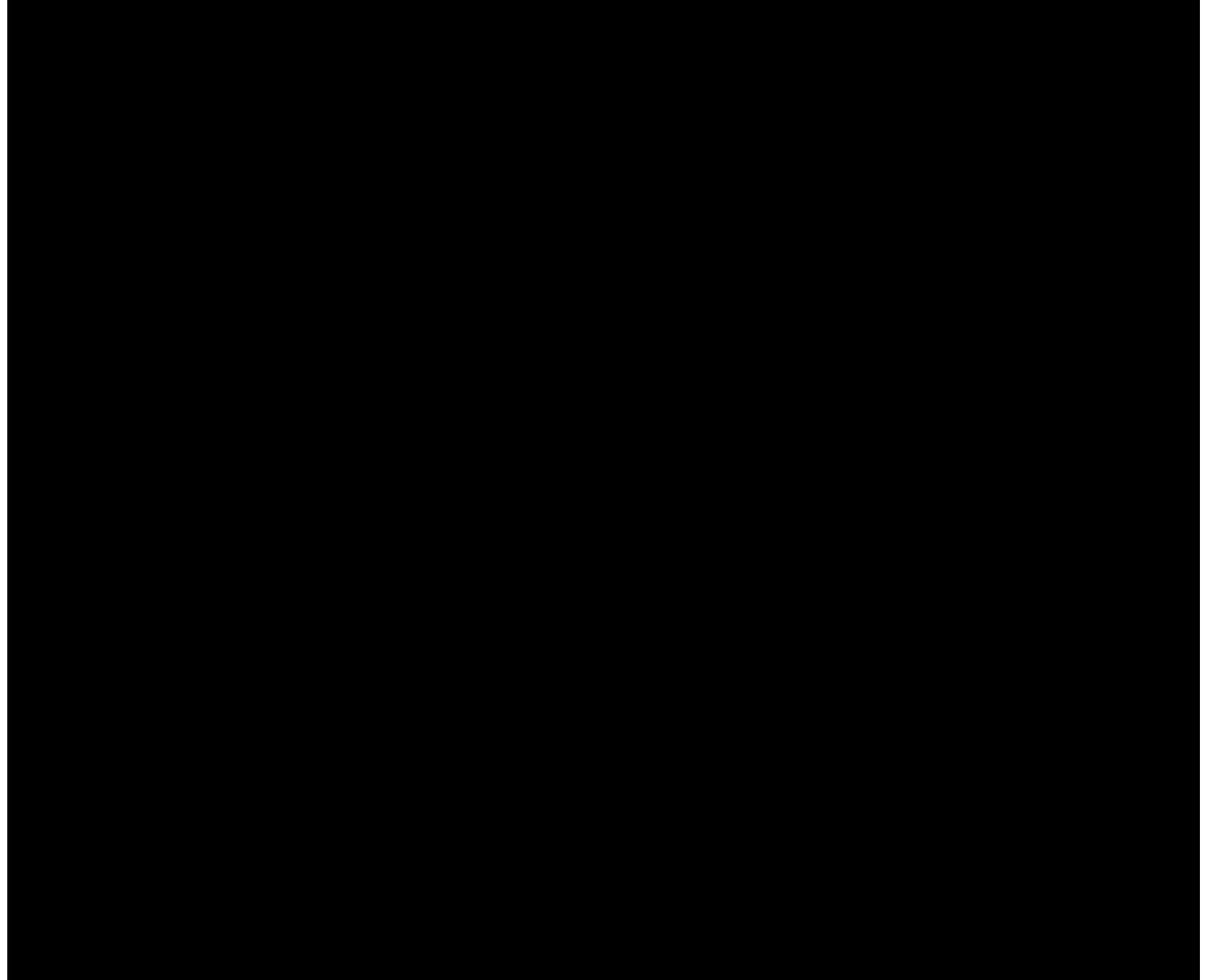




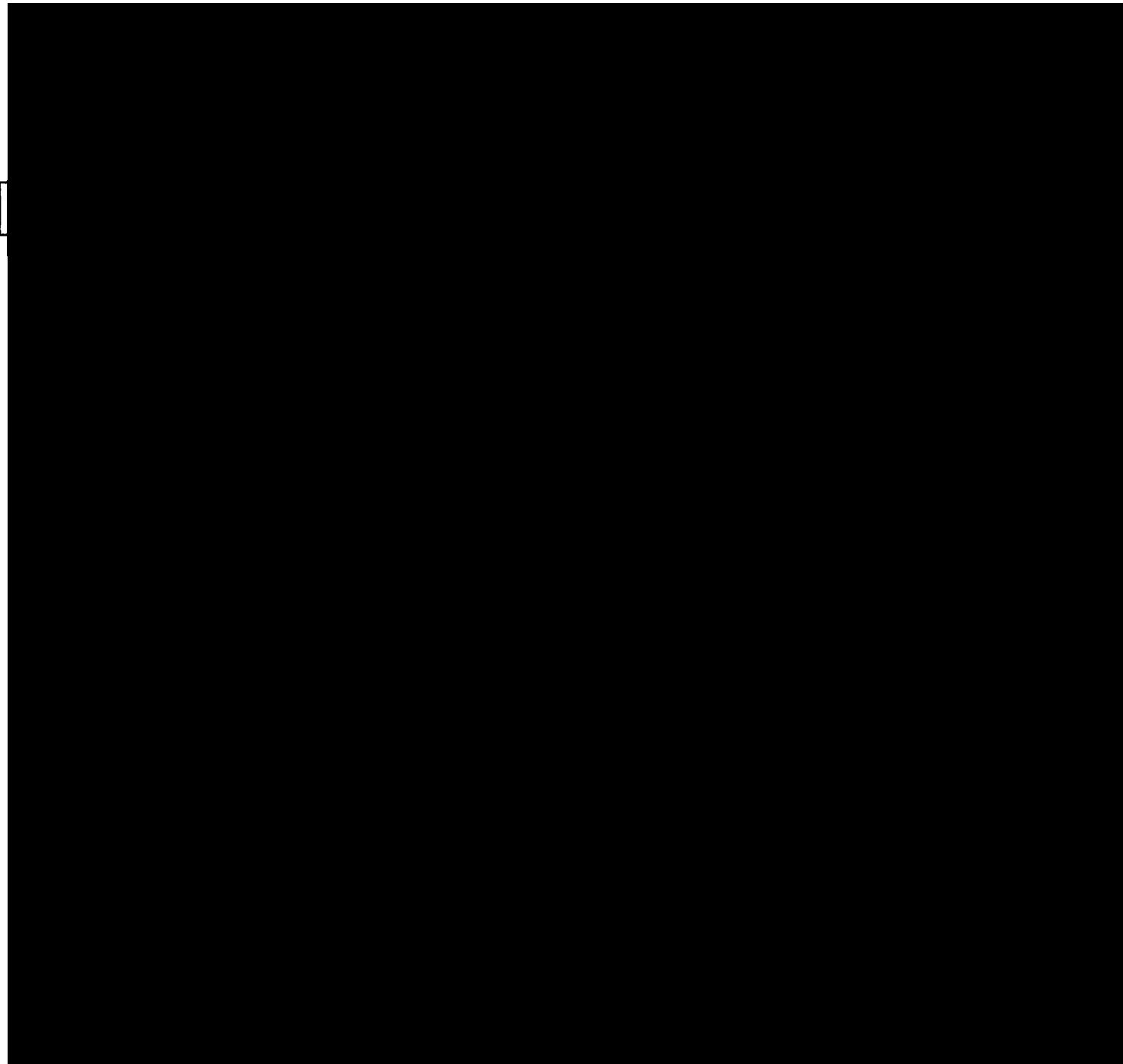


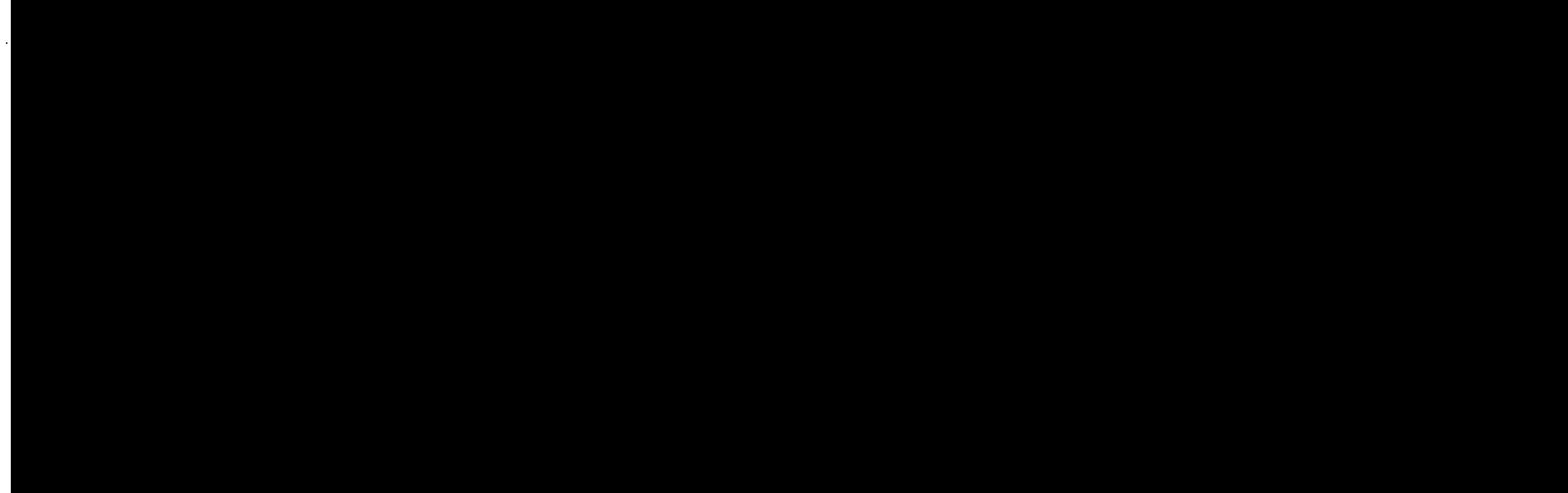




















## CERTIFICATE OF SERVICE

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:

David Pruitt  
c/o John J. Carney, Esq.  
Jimmy Fokas, Esq.  
Margaret E. Hirce, Esq.  
Bari R. Nadworny, Esq.  
Baker Hostetler  
45 Rockefeller Plaza  
New York, NY 10111-0100  
jcarney@bakerlaw.com  
jfokas@bakerlaw.com  
mhirce@bakerlaw.com  
bnadworny@bakerlaw.com



H. Gregory Baker