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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

UNITED STATES OF AMERICA, Plaintiff, v. GREGORY L. REYES, Defendant.	CR 06-0556 CRB THE UNITED STATES' RESPONSE TO THE DEFENDANT'S MOTION FOR A JUDGMENT OF ACQUITTAL

The United States of America, by and through its undersigned counsel, hereby responds to Gregory L. Reyes' Memorandum of Points and Authorities in Support of the Motion for Judgment of Acquittal dated July 3, 2007 ("Defendant's Memo"). For the reasons set forth herein, the motion should be denied.

I. THE STANDARD FOR DECIDING A RULE 29 MOTION

When considering a motion for acquittal under Federal Rule of Criminal Procedure 29, the district court must view the evidence in the light most favorable to the government and draw all reasonable inferences in the government's favor.

"[T]he relevant question is whether, after viewing the evidence in the light most favorable to the prosecution, any rational trier of fact could have found the essential elements of the crime beyond a reasonable doubt." *United States v. Alarcon-Simi*, 300 F.3d 1172, 1176 (9th Cir. 2002) (internal quotation omitted); *see also United States v. Salmonese*, 352 F.3d 608, 618 (2d Cir. 2003) (that inferences favorable to the defendant could also be drawn from the evidence is of no import because "the task of choosing among permissible competing inferences is for the jury, not a reviewing court").

The Court may not view the government's evidence in isolation, but must examine that evidence in conjunction and as a whole. *United States v. Brodie*, 403 F.3d 123, 134 (3d Cir. 2005). Circumstantial evidence and reasonable inferences drawn from that evidence alone are sufficient to sustain a conviction. *United States v. Reyes-Alvarado,* 963 F.2d 1184, 1188 (9th Cir. 1992); *United States v. Nelson*, 419 F.2d 1237, 1239 (9th Cir. 1969) ("For at least a third of a century, this court has rejected the notion that it is improper to infer a fact issue from other facts which have been established by circumstantial evidence;" "[C]ircumstantial evidence is not inherently less probative than direct evidence. Under some conditions it may even be more reliable . . . ."). The court must also credit both direct and circumstantial evidence without evaluating or speculating on the weight the jury might give it. *United States v. Martin*, 228 F.3d 1, 10 (1st Cir. 2000).

In ruling on a Rule 29 motion, a district court "must bear in mind that 'it is the exclusive function of the jury to determine the credibility of witnesses, resolve evidentiary conflicts, and draw reasonable inferences from proven facts.'" *Alarcon-Simi*, 300 F.3d at 1176 (*quoting United States v. Rojas*, 554 F.2d 938, 943 (9th Cir. 1977)). Thus, this Court may not weigh the evidence, substitute its opinion for that of the jury, or make credibility determinations. *United States v.*

Giampa, 758 F.2d 928, 934–35 (3d Cir.1985). The Court's only function at this stage is to determine whether the government adduced evidence sufficient to sustain a conviction. *Id.* Indeed, "A finding of insufficiency should be 'confined to cases where the prosecution's failure is clear.' Courts must be ever vigilant in the context of Fed.R.Crim.P. 29 not to usurp the role of the jury by weighing credibility and assigning weight to the evidence, or by substituting its judgment for that of the jury." *Brodie*, 403 F.3d at 133 (citations omitted).

II. TO PROVE CRIMINAL INTENT, THE EVIDENCE MUST SHOW ONLY THAT THE DEFENDANT KNEW HE ENGAGED IN A WRONGFUL ACT

The Ninth Circuit in *Tarallo* outlined three basic elements needed to satisfy 15 U.S.C. § 78ff. First, there must be criminal intent as defined by the term "willful." Second, the defendant's conduct, whether he knew it or not, must violate the securities laws. Third, the defendant's conduct, again, whether he knew it or not, must involve a significant risk of affecting the violation that has occurred. *Tarallo*, 380 F.3d at 1187.

A. Willfully

To prevail, the evidence must prove that the defendant acted "willfully." 15 U.S.C. § 78ff. To prove the defendant acted "willfully," it is "necessary only that the prosecution establishes a realization on the defendant's part that he was doing a wrongful act." *United States v. Tarallo*, 380 F.3d 1174, 1187 (9th Cir. 2004)(internal quotation, citation omitted). *See also, United States v. O'Hagan*, 139 F.3d 641, 647 (8th Cir. 1998) ("Courts that have interpreted "willfully" in [15 U.S.C. § 78ff(a)] have reached the same conclusion that we reach in this case: "willfully" simply requires the intentional doing of the wrongful acts – no knowledge of the rule or regulation is required.").

If the evidence establishes that the defendant acted knowing that he was doing a wrongful act, then the government has met its burden with regard to the required criminal intent.[1] It is

[1] The defendant's suggestion that "wrongful" means "inevitably nefarious, clearly 'reprehensible,' or obviously evil," Defendant's Memo. at 27 n.15 (citing *Ratzlaf v. United*

well-settled that the government need not prove that the defendant knew that he was breaking the law. *Tarallo*, 380 F.3d at 1187. Indeed, the defendant need not even be aware of the existence of the rule he is alleged to have violated. *Id*. S*ee also United States v. Schwartz*, 464 F.2d 499, 509 (2d Cir. 1972)("The final clause of [15 U.S.C. § 78ff(a)], however, makes it clear that the statute contemplates a 'willful' violation by one who has no knowledge of the violated rule or regulation. Since specific intent to violate the law presupposes knowledge of the law, it follows that such a specific intent is not necessary to sustain a conviction.").

The government need not prove that the defendant was familiar with a statute, regulation, accounting rule, or anything else as long as he knows what he is doing is wrong. In *United States v. Brown*, 578 F.2d 1280 (9th Cir. 1978), for example, the defendant argued that the government failed in its proof because it had not shown that he was aware that his conduct related to a "security" under the federal securities laws. The Ninth Circuit rejected this argument:

> We think that the government is required to prove specific intent only as it relates to the action constituting the fraudulent, misleading or deceitful conduct, but not as to the knowledge that the instrument used is a security under the Securities Act. The government need only prove that the object sold or offered is, in fact, a security; it need not be proved that the defendant had specific knowledge that the object sold or offered was a security.

Id. at 1284. As the court observed, requiring proof only that the defendant knew his conduct was wrongful "is not a trap for the unwary because the thrust of it [*i.e.*, the federal securities laws] is fraud." *Id*.; *see also United States v. English*, 92 F.3d 909, 915 (9th Cir. 1996) (securities laws do not require proof of a specific intent to break the law; "[s]ince fraud is an inherently bad act . . .

States, 510 U.S. 135, 137 (1994)), has been repeatedly rejected in the context of securities law violations. *See, e.g., O'Hagan*, 139 F.3d at 647 (the rationale of *Ratzlaf* does not apply to 15 U.S.C. § 78ff); *English*, 92 F.3d at 914-16 (distinguishing *Ratzlaf* (where the Court was concerned with a different statutory scheme and the criminalization of innocent behavior), from cases of securities fraud, which are "not a trap for the unwary because the thrust of it is fraud") (citations, internal quotation omitted); *Charnay*, 537 F.2d at 357 ("Proof of an 'evil motive' appears unnecessary.") (citation omitted) (Sneed, J., concurring).

there is no danger in prosecuting the innocent, feckless, or reckless") (internal quotation, citation omitted).

B. Conduct Caused a Significant Risk of a Violation of the Securities Law

Apart from the defendant's criminal intent, the evidence must independently prove that the defendant's act violated the securities laws. This requires nothing more than that the government prove the other non-scienter elements required in any securities fraud case. In addition, the defendant's act must involve "a significant risk of effecting the violation that has occurred." *Tarallo*, 380 F.3d at 1187 (internal quotation, citation, footnote omitted). This other evidence, however, is independent of the proof of the defendant's mental state, *i.e.*, that he knew he was engaged in a wrongful act.

If he willfully participated in an act that involves a "significant risk" of violating the securities laws, then the defendant is criminally liable. *Charnay*, 537 F.2d at 352 (indictment sufficient where it "alleges a knowing participation by all of the defendants in the perpetration of the manipulation which created the artificially depressed market price and consequent fraud and deceit."); *Schwartz*, 464 F.2d at 509 ("Proof of a specific intent to violate the law is not necessary . . . provided that satisfactory proof is established that the defendant intended to commit the act prohibited.").

United States v. Peltz, 433 F.2d 48 (2d Cir. 1970) is the seminal case on this issue. In *Peltz*, the defendant was convicted of, among other things, violating SEC Rule 10a-1(a) (which prohibits a person from engaging in certain short sale trading) by falsely telling a broker that he owned the securities sold. After the court determined that the government did not need to prove that the defendant knew of Rule 10a-1(a), the question remained what mental state the government was required to show. The analysis articulated by Judge Friendly has been adopted by the Ninth Circuit, as set out in *Tarallo*:

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> [I]t was necessary only that the prosecution establishes a realization on the defendant's part that he was doing a wrongful act. We accept this with the qualifications . . . that the act be wrongful under the securities laws and that the knowingly wrongful act involve a significant risk of effecting the violation that has occurred.

Peltz, 433 F.2d at 55 (internal quotation and citations omitted). The court found that there was "ample evidence that Peltz was aware 'he was doing a wrongful act,' namely, telling the brokers he was long when he knew he was not." *Id.* Peltz – like this defendant – lied. That was legally sufficient to establish that Peltz knew he was doing a wrongful act. The other elements were satisfied by evidence of the defendant's conduct independent of his state of mind: "His false statements, negating the facts that would have induced the brokers to take the requisite steps to avoid a violation of 10a-1(a), created a serious risk that such a violation would occur, as it did." *Id*. (citation omitted).

Similarly in *United States v. Dixon*, 536 F.2d 1388 (2d Cir. 1976), the defendant was the president of a public company charged with, among other things, filing a false Form 10-K that failed to disclose loans to company insiders in excess of $20,000 as required by regulation. The court rejected the defendant's argument that there was insufficient evidence of his state of mind to support a conviction:

> Dixon did a "wrongful act," in the sense of our decision in *Peltz*, when he caused the corporate books to show, as of December 31, 1970, debts of his father and of Lewis which in fact were his own. True, Dixon may have thought his year-end thimblerig would provide escape from a rule different from the one that existed. But such acts are wrongful "under the Securities Acts" if they lead, as here, to the very violations that would have been prevented if the defendant had acted with the aim of scrupulously obeying the rules (which would have necessarily involved correctly ascertaining them) rather than of avoiding them. Such an intention to deceive is enough to meet the modest requirements of the first clause of [15 U.S.C. 78ff(a)] when violations occur.

Id. at 1396; *see also United States v. Chiarella*, 588 F.2d 1358, 1371 (2d Cir. 1978), *rev'd. on other grounds*, 445 US 222 (1980) ("under the *Peltz-Dixon* test, the willfulness requirement of

[15 U.S.C. 78ff(a)], is satisfied by a general awareness of wrongful conduct, which may exist even if a defendant believes his chicanery is in technical compliance with the law").

That the securities laws impose such a "modest" level of proof of scienter is grounded in part on the fact that a criminal conviction under those laws "necessarily involves fraudulent conduct and breaches of duty by the defendant. Such acts do not involve conduct that is often innocently undertaken." *O'Hagan*, 139 F.3d at 647; *see also, e.g., English*, 92 F.3d at 915.

In addition, the federal securities laws are "public welfare offenses" and do not "encounter the same demanding constitutional and interpretive standards applicable to other criminal offenses." *Charnay*, 537 F.2d at 355, 356 ((neither § 10(b) nor Rule 10b-5 is "interpreted narrowly when employed as a basis for criminal prosecution, even though a narrow interpretation is ordinarily considered proper with respect to statutes defining crimes") (Sneed, J., concurring). As a result the same "expansive interpretation necessary to insure the maintenance of fair and honest exchanges" employed in civil securities fraud actions is employed in criminal ones. *Id*. at 356

This modest level of proof is further informed by the fact that a defendant may not be imprisoned – although he may be convicted – for violating the securities laws if he proves at sentencing that he had no knowledge of the rule or regulation. *Tarallo*, 380 F.3d at 1188; *see also United States v. O'Hagan*, 521 U.S. 642, 665-66 (1997) (15 U.S.C. § 78ff's "willfulness" test and its provision that a defendant may avoid incarceration if he proves he had no knowledge of the applicable rule are "two sturdy safeguards Congress has provided regarding scienter"); 15 U.S.C. § 78ff(a).

As one court put it, the rationale in other cases concerning other statutory schemes, "that knowledge of the law is required in order to prevent criminal conviction for conduct that may often be innocently undertaken, does not apply to [15 U.S.C. § 78ff]. Criminal conviction for violation of rules and regulations implementing § 10(b) necessarily involves fraudulent conduct

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breaches of duty by the defendant. Such acts do not involve conduct that is often innocently undertaken." *O'Hagan*, 139 F.3d at 647.[2]

Analytically, the common elements of the securities fraud violations at issue in this trial reduce themselves to the following two questions: First, did the defendant do something he knew was wrongful? Yes, he falsified Brocade's stock option grant minutes and then lied about it (described at length below), which is legally sufficient proof that he acted with an intent to do something wrong. Second, did the defendant's conduct involve a "serious risk" of the violation of the securities laws? Yes, the defendant's falsification of the stock option grant minutes resulted in the falsification of the company's books and records, resulted in false statements being made to the auditors, caused the company to file financial statements with the SEC that materially inflated Brocade's bottom line, and misled Brocade's shareholders and the investing public.[3]

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[2] *United States v. Cassese*, 428 F.3d 92 (2d Cir. 2005), cited by the defendant at the July 6 hearing, is not helpful. In that case the parties disagreed about the proper standard. The defendant argued that to show willfulness the government was required to prove that the defendant specifically knew that the transaction he traded on was a tender offer under the securities laws. The government, on the other hand, took the position that it was not required to prove that that the defendant knew that he was violating a rule that governed trading relating to a tender offer, but rather was required to prove only that he realized that he was committing a wrongful act. *Id*. at 97-98. The Second Circuit did not purport to redefine the well-established definition of willfulness, determining that the government had not met its burden under even that standard. *Id*.; *see also id.* at 103 ("The majority finds it unnecessary to reach this issue, concluding that, even if willfulness only requires proof that Cassese generally understood the unlawfulness of his actions, the government failed to carry its burden.") (Raggi, J., dissenting).

[3] The scienter element can be satisfied by evidence that the defendant acted recklessly as well as intentionally. Reckless conduct involves not merely simple, or even inexcusable, negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading investors or accountants that is either known to the defendant or is so obvious that he must have been aware of it. The defendant is reckless if he had reasonable grounds to believe material facts existed that were misstated or omitted, but nonetheless failed to obtain and disclose such facts although he could have done so without extraordinary effort. *See, e.g.,Tarallo*, 380 F.3d at 1188-89; *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69

III. THE EVIDENCE IS LEGALLY SUFFICIENT TO PROVE THE DEFENDANT INTENDED TO DO SOMETHING HE KNEW WAS WRONG

A. The Defendant Routinely Executed Grant Minutes He Knew Were False

The critical fact of this case now seems uncontroverted: the defendant routinely engaged in so-called look-backs to pick low stock prices for the option grants using historical stock performance information. The inferences that naturally flow from this now-undisputed proof are laden with consequence for the defendant. If the grant minutes were signed using look-backs, then the defendant knew the corporate records he was signing were false.

This critical point is most clearly understood by following the logic of a single option grant using the look-back procedure. Take the so-called November 28, 2001 option grant (Ex. 912), for example. On January 28, 2002, Stephen Beyer used the look-back procedure to select the November 28, 2001 pricing date because it was a low stock price. Beyer at 257-58;[4] Ex. 128. Then, later in January 2002 or in early February 2002, Colleen Devine drafted for the first time the unexecuted grant minutes using the November 28, 2001 date. Devine at 133. After the unexecuted grant minutes were finalized, they were submitted by the HR personnel through Stephanie Jensen for the defendant's approval and signature. *Id.* at 135.

Through late January 2002, the defendant has had no involvement whatsoever in the so-called November 28, 2001 option grant. On or about February 6, 2002, Stephen Beyer announced that the defendant had executed the so-called November 28, 2001 grant minutes "yesterday." Ex. 134 ("[a]s of yesterday afternoon we have final signature approval for all Q1 QSAP stock as well as new hire stock through Jan 22 [*i.e.* the new hire grants on October 30,

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(9th Cir. 1990). The defendant acknowledges that proof of recklessness sufficies to establish scienter. *See* Defendant's Memo. at 22.

[4] The government's citations to the trial transcript reference the witness's name followed by the page numbers.

2001, November 28, 2001 and January 22, 2002]"). Therefore, we know that the defendant first approved and executed the so-called November 28, 2001 option grant sometime between late January 2002 and February 5, 2002.

A rational juror could reasonably conclude the following: First, contrary to what is stated on the minutes, there was no "meeting" on November 28, 2001. *See* Ex. 912 ("Committee of the Board of Directors Meeting Date: November 28, 2001"). Second, the date of November 28, 2001 was selected by the HR personnel without any involvement of defendant Reyes. Third, the defendant knew that the grant minutes were false because he knew there was no meeting on November 28, 2001 and because he knew that the fair market price of the stock on the day he signed the grant minutes was not the price stated on the minutes . *See id.* ("Fair Market Value: $28.82"). And fourth, knowing the document was false, the defendant signed the grant minutes anyway.

As a general matter, the same logic applies to all the other approximately eight-eight (88) grant minutes executed after the fact using the look-back procedure. *See* Exs. 947, 947.1 (listing grants at issue). Therefore, the government is entitled to the reasonable inference that the defendant knew the grant minutes he signed using the look-back procedure were false.

B. The Defendant's Lies About the Look-Backs at Brocade Are Legally Sufficient to Prove He Knew What He Did Was Wrong

Having routinely executed grant minutes he knew were false, the question becomes did the defendant execute the false grant minutes with an intent to do something wrong? A juror could reasonably conclude that the defendant executed the false grant minutes knowing that he was doing something wrong because he lied about it.

Craig Martin left no doubt that defendant Reyes stated repeatedly that there were no look-backs to price option grants at Brocade. Martin at 2155-56, 2158-60, 2212-13. Why would this defendant lie about the use of look-backs? He lied for the same reason many criminal defendants lie about their conduct. He lied because he knew he had done something wrong.

False exculpatory statements are evidence of consciousness of guilt. *United States v. Perkins*, 937 F.2d 1397, 1401-1402 (9th Cir. 1991) (approving the following instruction when a defendant lied to an arresting officer: "Conduct of a defendant, including statements knowingly made and acts knowingly done upon being informed that a crime has been committed, or upon being confronted with a criminal charge, may be considered by the jury in light of all other evidence in the case in determining guilt or innocence. When a defendant voluntarily and intentionally offers an explanation or makes some statement tending to show his innocence, and this explanation or statement is later shown to be false, the jury may consider whether this circumstantial evidence points to a consciousness of guilt. Ordinarily it is reasonable to infer that an innocent person does not usually find it necessary to invent or fabricate an explanation or statement tending to establish his innocence. Whether or not evidence as to a defendant's voluntary explanation or statement points to a consciousness of guilt, and the significance to be attached to any such evidence, are matters exclusively within the province of the jury."); *United States v. Wood*, 550 F.2d 435, 442-43 (9th Cir. 1976) (approving jury instruction providing that "when a statement is made alleging innocence which later is shown to be false, it is ordinary to infer a consciousness of guilt."); *see also United States v. Newman*, 6 F.3d 623, 628-29 (9th Cir. 1993) (because jury could infer that defendant lied to investigators about being near the scene of a fire, his false exculpatory statements were evidence of consciousness of guilt); *United States v. Ruggiero*, 56 F.3d 647, 655 (5th Cir. 1995) ("After the investigation into his transactions commenced, Parker lied to the SEC, conferred with Ruggiero, and then changed his story. A reasonable juror could conclude that these actions indicated that Parker knew the information that he received from Ruggiero was improperly acquired, and that the evidence was sufficient for a reasonable juror to find knowledge or at least recklessness."); *SEC v. Musella*, 748 F. Supp. 1028, 1040 (S.D.N.Y. 1989), *aff'd*, 898 F.2d 138 (2d Cir. 1990) (defendant's "false exculpatory statement evidences consciousness of guilt and has independent probative value of scienter"). At a minimum, the defendant's motion should be denied because the government is entitled to the

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inference that a juror could reasonably infer the defendant lied about the look-backs because he knew what he did was wrong.

C. The Defendant Knew The Look-Backs Had Accounting Consequences

For the reasons cited above, it is enough for the government to prove, as it has, that the defendant routinely falsified corporate records knowing that it was wrong and that the defendant's conduct caused a significant risk of violating the securities laws by misrepresenting the true financial condition of the company to the public. The evidence is more than legally sufficient on these core points.

By its questions at the July 6, 2007 hearing, the Court seemed to imply that the government was required to go further and prove that the defendant knew that his wrongful conduct had accounting implications for Brocade. Respectfully, we do not agree that the government was required to prove that the defendant had knowledge of the accounting rules that he violated. But even if we were required to prove this additional element, the proof is more than legally sufficient to establish that the defendant knew the accounting implications of his fraud.

1. KPMG Representation Letters

There can be no doubt that the defendant knew the option grant minutes he routinely falsified were relevant to disclosure requirements of a publicly-traded company like Brocade.

On November 18, 2002, defendant Reyes signed the nine (9) page management representation letter to Brocade's auditors KPMG LLP. Ex. 44. Among other representations, the defendant stated that "we have made available to you: ... [a]ll minutes of the meetings of ... committees of directors." Ex. 44 at 1. The defendant further represented that "[t]here have been no ... [i]nstances of fraud, whether material or not, involving management." Ex. 44 at 2. In the first sentence of his letter, the defendant assured KPMG LLP that "[w]e are providing this letter to you in connection with your audit of the consolidated balance sheets of Brocade Communications Systems, Inc." Ex. 44 at 1.

The November 18, 2002 management representation letter leaves no question that defendant Reyes knew Brocade's auditors would rely on the option grant minutes ("[a]ll minutes

of the meetings of ... committees of directors") to prepare Brocade's financial disclosures to its shareholders and the public. The defendant also assured the auditors that the option grant minutes were true and accurate ("no fraud, whether material or not"). Yet the evidence shows that the grant minutes were false. Thus, the defendant lied to Brocade's auditors.

The defendant falsified the grant minutes to deceive his finance personnel. Moore at 892, 896-98, 900-01 (testifying that, for employee grants, she believed the stock price was set on the date Greg Reyes as the "committee" met to set the price, and nothing on the committee minutes indicated otherwise to her). Like most frauds, the defendant engaged in a cover-up of his wrongdoing. As a result, he lied to Brocade's auditors in the management representation letter and, as we will see, to Brocade's shareholders in the SEC Form 10-K.

2. The 2002 SEC Form 10-K Certified by the Defendant

As the government tried to emphasize during oral argument, the defendant's signature and certification on Brocade's 2002 SEC Form 10-K can be properly viewed as a statement by the defendant. As such, it is one of the clearest and most direct forms of evidence that he knew that his falsification of the option grant minutes would have direct accounting consequences that would cause Brocade to under-report its compensation expenses and thus falsely inflate the company's bottom-line.

For example, Brocade's SEC Form 10-K for fiscal year 2002 includes the following disclosure under "Summary of Significant Accounting Policies" (Ex. 27 at 50):

> *Stock-Based Compensation*
>
> The Company accounts for its stock option plans ... in accordance with the provisions of Accounting Principles Board Opinion 25, "Accounting for Stock Issued to Employees," (APB 25), *whereby the difference between the exercise price and the fair market value at the date of grant is recognized as compensation expense*.

Ex. 27 at 54 (emphasis added). Even if he had no understanding of APB 25, the defendant clearly understood that if you granted options at a price below the fair market value then you had a compensation expense. That options granted below the market price (or in the money) have a expense associated with them is not a complicated or esoteric concept. June Weaver understood

it. Weaver at 556-58. Similarly, the notion that expenses hurt the bottom-line is also not complicated or esoteric. *See e.g. id*. at 547-48.

Even if these were sophisticated concepts, the defendant affirmatively represented that:

> I have reviewed this annual report on Form 10-K of Brocade Communications Systems, Inc.; ... Based on my knowledge, the financial statements, and other financial information included in the annual report, fairly present in all material respects the financial condition ... for the periods presented in this annual report; ...[Brocade's] other certifying officer and I have disclosed ... to [Brocade's] auditors ... any fraud, whether material or not, that involves management ...

Ex. 27 at 80. The defendant asked Brocade's auditors and shareholders to rely on his specific assurance that he understood what was in the 2002 SEC Form 10-K. It is not unreasonable for the jurors also to rely on the defendant's assurances.

At this juncture, the government is entitled to the reasonable inference that the defendant actually meant what he said when he insisted that he reviewed and understood the representations in Brocade's Form 10-K for 2002. In our view, the reasonable inferences that may be drawn from the defendant's representations that "*the difference between the exercise price and the fair market value at the date of grant is recognized as compensation expense"* is dispositive as to his actual understanding of the accounting consequences of his falsification of the option grant minutes.[5]

3. Other Evidence The Defendant Knew About The Accounting Consequences of Falsifying The Option Grant Minutes

In addition to the management representation letters and the SEC Form 10-Ks, a juror could reasonably rely on a variety of other evidence in the trial record to conclude that the

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[5] The government does not seek to hold the defendant strictly liable for any falsehood in Brocade's SEC Form 10-K. But the government does seek to hold him criminally responsible for his own willful and intentional falsification of corporate records that resulted in under-reported compensation expenses and thus falsely inflating the company's bottom line. CEO's that certify a company's SEC Form 10-K reports in good faith have nothing to fear from this case. CEO's, like Greg Reyes, who intentionally mislead their auditors and shareholders as part of a scheme to falsify inflate their bottom line, are properly held responsible for their criminal wrongdoing as they have been since the Securities and Exchange Act of 1934 was first enacted.

defendant understood there were accounting consequences that flowed from his deliberate falsification of the option grant minutes.

First, Craig Martin testified that he specifically asked the defendant during their January 2005 meeting whether he understood the implications of granting in-the-money options and the defendant responded that he did understand those implications sometime during his tenure as Brocade CEO. Martin at 2157, 2201-03. A juror could reasonably infer that the defendant had that understanding at least from the time when he signed the fiscal year 2001 Form 10-K (which included the very same language as the 2002 10-K clearly stating that options granted at below fair market price resulted in a compensation expense, Ex. 22 at 50). Mr. Martin's testimony is a further corroboration that the defendant always understood the basic accounting rule that in-the-money options require the company to record a compensation expense. Such an inference is certainly more reasonable than the defense claim that the defendant first learned about the implications of in-the-money options as a result of the internal investigation, which is unsupported by the trial record.

Second, Stephanie Jensen sent an iQuantic PowerPoint to the defendant on June 9, 2003. Ex. 187. June Weaver , who also received the iQuantic PowerPoint from Jensen, testified that option expense issues were a key issue for Brocade that was being studied by a management group that included the defendant. Weaver at 547-48. The iQuantic PowerPoint has a slide that spells out the "current rules" for APB 25 in comparison to new rules proposed under SFAS 123. Ex. 187 at 28. The slide has a succinct description of the "current rules" under APB 25:

> » No charge to earnings for options granted at or above FMV
>
> » Fixed accounting charge equal to "spread" for options granted at a discount

Ex. 187 at 28. The contention that the defendant did not read his e-mail – like the contention that he did not read the SEC Form 10sK when he said he did – goes to the weight of the evidence. Indeed, the record shows that the defendant proactively reached out to the group to keep him informed of its work in connection with the new rule, was kept apprised of the workings of the

group, and read the e-mails that were sent to him on this subject.[6] At this point, the government is entitled to the reasonable inference that the defendant read and understood this basic synopsis of the accounting rules for stock option expenses that he received as part of this process.

Third, the defendant wrote James Bidzos an e-mail on October 8, 2004 in which he stated unequivocally:

IT IS ILLEGAL TO BACK DATE OPTION GRANTS.

Ex. 648 (original emphasis). James Bidzos explained the context of this e-mail pertained to efforts by Verisign's management to backdate an option grant from October 2004 to August 2004. Bidzos at 2076-79.

A fair reading of the e-mail leaves no doubt that the defendant understood that back-dating options was illegal. It would be reasonable for a juror to infer that the defendant would write such an e-mail in the context his service on the Audit Committee of another company even as he continued to backdate employee options at Brocade while operating within the relative secrecy of his exclusive authority to grant options to employees. The defense claim that this e-mail pertained exclusively to the then-new Sarbanes-Oxley regulations was rejected by the witness. Bidzos at 2118-20. These are all reasonable inferences based on the trial record to which the government is entitled.

4. "It's Not Illegal If You Don't Get Caught"

Four witnesses testified that they felt uncomfortable enough about the defendant's backdating scheme to discuss it with their supervisors or co-workers. *See e.g.* Devine at 120-22;

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[6] *See* Ex. 232 (email from Weaver to Reyes attaching draft of new accounting rule and stating, "This change in stock option expensing will have a significant impact on our current stock option practices . . . ," to which Reyes responds, "Thanks. Please keep us posted."); Ex. 243 (email from Weaver to Reyes describing the proposed change in accounting for employee stock options, to which Reyes responds, "Thanks, June. When do you expect the analysis to be complete?"); Ex. 177 (2003 email from Weaver stating that with respect to the "expensing of options," "Greg has talked with a number of his colleagues, reads about this topic in newspapers and articles, and is very interested in Brocade handling this properly").

Beyer at 267-68; Lee at 389-90; and Weaver at 746, 819-20. Mr. Beyer raised his concerns with Stephanie Jensen, who told him that they "had been directed by Greg Reyes to complete the process, and [they] were going to do so." Beyer at 268. And June Weaver testified that, in the context of delivering back-dated minutes to the defendant for his signature, he told her "It's not illegal if you don't get caught." Weaver at 567, 817. Whatever weight the jury may ultimately give it, this evidence supports a reasonable inference that the defendant was talking about the back-dating of option grants. For the moment, the Court must give the government all of the reasonable inferences that flow from Weaver's testimony about what the defendant said.

D. No Reason To Falsify Grant Dates Except To Hide Expenses

Finally, it is important to return to the internal logic of the fraud in the form of the grant minutes themselves. The defense's unsupported assertion that the backdating was done in full view of the finance department fails to consider one critical detail. The HR department not only looked for the low prices, but it then inserted the dates of those closing prices on the draft minutes. *See e.g.* Weaver at 448-50.

Granting options at low prices to help your employees is fine if you account for it properly and recognize the resulting compensation expenses. But compelling the HR personnel to insert the date of the low price, the defendant's scheme insured that the employees received the benefit of the low prices while Brocade (illegally) avoided the cost of the resulting compensation expense. There is absolutely no reason to use the date of the low price except to avoid the compensation expense. None.

A careful study of the falsified option grant minutes reveals a scheme consistent with only one thing: fraud. The logic of the falsified grant minutes themselves is consistent only with an intentional and systematic effort to mislead those who would rely on them about one issue and one issue only: whether there would be a compensation expense for the option grants. Nothing else reasonably explains the totality of the trial evidence.

This crime was not an accident. This was not a case of reliance on bad accounting advice. (Indeed, there is no evidence even to support such an inference.) This was an intentional

and routine effort to game the system to keep the company growing while avoiding compensation expenses that would hurt the bottom line. It was undertaken by a powerful CEO who thought he could operate with impunity within the murkiness of his committee of one. The only witnesses who had any real insight into what the defendant did are those that testified, the handful of comparatively powerless HR personnel who were cowed into carrying out the defendant's scheme.

At least, that is the conclusion a juror drawing all the logical inferences favorable to the government could reasonably reach. The motion therefore must be denied.

CONCLUSION

The Rule 29 motion should be denied and the case should go to the jury for their verdict. Alternatively, the Court should defer a ruling on this motion until after the jury has rendered a verdict.

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Respectfully submitted,

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