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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

UNITED STATES OF AMERICA,	)	CASE NO. C06-70450 CRB (JCS)
)	
Plaintiff,)	
	)	DEFENDANT GREGORY L.
v.	)	REYES'S NOTICE OF MOTION
	)	AND MOTION TO DISMISS
GREGORY L. REYES, et al.,	)	CRIMINAL COMPLAINT, OR,
	)	IN THE ALTERNATIVE,
Defendants	)	REQUEST FOR AN
	)	EXPEDITED PRELIMINARY
	)	HEARING; MEMORANDUM
	)	OF POINTS AND
	)	AUTHORITIES IN SUPPORT
	)	THEREOF

Date: August 2, 2006
Time: 2 p.m.
Judge: Hon. Joseph C. Spero
Courtroom: A, 15th Floor

NOTICE OF MOTION

TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that on August 2, 2006, at 2 p.m., or as soon thereafter as the matter may be heard, in Courtroom A of the above-referenced court, before Honorable Joseph C. Spero, defendant Gregory L. Reyes will, and hereby does move this Court, pursuant to Federal Rules of Civil Procedure 4(a), for an order dismissing the complaint.

The Motion will be based on this Notice, the Memorandum of Points and Authorities, all of the pleadings, records and files in this action, all matters of which this Court may take judicial notice, and such other documents and argument as may be presented on or prior to the date set for decision.

DATED: July 27, 2006

Respectfully submitted,

SKADDEN, ARPS, SLATE, MEAGHER & FLOM
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By: /s/ Richard Marmaro
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5	Peter J. Henning, <u>Are Backdating Cases Really Securities Fraud?</u> , The American	
6	Lawyer, July 27, 2006, available at	
7	http://www.law.com/jsp/article.jsp?id=1153904731954	3

MEMORANDUM OF POINTS AND AUTHORITIES

I. ISSUES TO BE DECIDED

For a criminal complaint to support the issuance of a summons, the supporting affidavit must state in nonconclusory terms the “essential facts constituting the offense charged.” Fed. R. Crim P. 3; United States v. Greenberg, 320 F.2d 467, 472 (9th Cir. 1963). This includes setting forth the underlying circumstances supporting the government’s allegations, identifying the sources of the information, and establishing the reliability and veracity of hearsay witnesses. Giordenello v. United States., 357 U.S. 480, 485, 84 S. Ct. 1509, 1513-1514, 12 L. Ed. 2d 723 (1958); Aguilar v. Texas, 378 U.S. 108, 113-114, 84 S. Ct. 1509, 1513-14, 12 L. Ed. 2d 723 (1964). Together, these facts must be sufficient to support a magistrate’s independent determination of probable cause. Fed. R. Crim. P. 4(a); Giordenello, 357 U.S. at 485, 78 S. Ct. at 1249.

As a result, this case presents three issues for review:

- (1) Whether a criminal complaint that charges federal securities fraud, but fails to state any facts constituting the required mental state for that offense, provides sufficient basis to support the issuance of a summons.
- (2) Whether a criminal complaint that states, in conclusory fashion, what unidentified documents and unnamed witnesses “indicate” without disclosing the information related by those sources, provides sufficient basis to support the issuance of a summons.
- (3) Whether a criminal complaint that relies on unnamed hearsay witnesses, but fails to set forth facts supporting the reliability or veracity of those witnesses, provides sufficient basis to support the issuance of a summons.

II. PRELIMINARY STATEMENT

The complaint in this case fails to meet the basic sufficiency standards established by the Fourth Amendment, the Federal Rules of Criminal Procedure, and Supreme Court precedent. Rule 3 of the Federal Rules of Criminal Procedure requires a complaint to set forth the “essential facts constituting the offense charged.” Fed. R. Crim. P. 3. Taking its mandate from the Fourth Amendment, Rule 4 of the Federal Rules of Criminal Procedure

1 requires that a complaint first state sufficient facts to establish probable cause before a
 2 summons¹ or arrest warrant may issue. Fed. R. Crim. P. 4(a); see also Giordenello, 357
 3 U.S. at 486-7, 78 S. Ct. at 1250.

4 The Supreme Court has long held that conclusory allegations are insufficient to
 5 support a finding of probable cause. See, e.g., Illinois v. Gates, 462 U.S. 213, 239, 103 S.
 6 Ct. 2317, 2332-33, 76 L. Ed. 527 (1983) (noting that a magistrate's determination "cannot
 7 be a mere ratification of the bare conclusions of others"); see also Giordenello, 357 U.S. at
 8 486, 78 S. Ct. at 1250. In Giordenello, the Supreme Court found that a complaint charging
 9 the defendant with unlawful possession of heroin was insufficient to support the issuance
 10 of an arrest warrant. Id. Like the complaint here, the Giordenello complaint alleged in
 11 conclusory fashion that Giordenello had committed the crime, without alleging the
 12 "essential facts" constituting the offense. The Court reasoned that because a complaint
 13 must demonstrate probable cause on its face, the magistrate "must judge for himself the
 14 persuasiveness of the facts [and] ... should not accept the mere conclusions that the person
 15 whose arrest is sought committed the crime." Id. (emphasis added). The court further
 16 explained that, absent underlying facts supporting the allegations, "it is difficult to
 17 understand how the Commissioner could be expected to assess independently the
 18 probability that petitioner committed the crime charged." Id. at 486-7.

19 Based on the above principles, the Supreme Court set forth the following
 20 guidelines for criminal complaints:

- 21 • The complaint must state with particularity the essential facts constituting
 22 a crime and sufficient to demonstrate probable cause. Id.

23 _____
 24 ¹ The requirement that a complaint demonstrate probable cause applies regardless
 25 of whether the government seeks issuance of a warrant or a summons. Fed. R. Crim. P. 4,
 26 1974 Advisory Committee Note (noting that the rule "make[s] clear that probable cause is
 27 a prerequisite to the issuance of a summons"); see also Greenberg, 320 F.2d at 472 ("We
 28 conclude, under the rationale of Giordenello that the requirement of Rule 4(a), ... that
 there is probable cause to believe that an offense has been committed and that the
 defendant has committed it, is required whether a warrant or summons is issued on the
 complaint.").

- The complaint must state the source of the facts alleged, including the substance of all documents or witness interviews forming the basis of the allegations. See Aguilar, 378 U.S. at 114, 84 S. Ct. at 1514 (1964); Greenberg, 320 F.2d at 472.
- The complaint must state facts establishing the veracity or reliability of hearsay witnesses. Aguilar, 378 U.S. at 114, 84 S. Ct. at 1514 (1964).

The criminal complaint here fails on all three counts. First, the complaint offers no facts establishing “probable cause” that Mr. Reyes acted with the **requisite scienter** for securities fraud.² Criminal prosecution under the federal securities laws requires that an individual act “willfully.” See 15 U.S.C. § 78ff(a). But aside from a single conclusory assertion that merely tracks the statutory language in alleging that “Defendants GREGORY L. REYES and STEPHANIE JENSEN did knowingly and willfully ... employ manipulative and deceptive devices” (Aff. ¶ 2), the government offers **no facts** establishing **criminal intent**. Second, although the complaint identifies in vague terms its reliance on “documentary evidence” and “witness interviews,” it fails to set forth **the information disclosed by those sources**. Instead, the complaint offers only the affiant’s bare conclusions made on the basis of unidentified “documents and witness interviews.” (See, e.g., Aff. ¶¶ 25, 28). Finally, the complaint relies on information purportedly gleaned from unnamed hearsay witnesses, but fails to set forth **a single fact** supporting either the reliability or veracity of those witnesses.

III. STATEMENT OF FACTS

Following a lengthy grand jury investigation, on July 20, 2006, the United States Attorney’s Office for the Northern District of California filed a complaint charging

² On this point, see Peter J. Henning, Are Backdating Cases Really Securities Fraud?, The American Lawyer, July 27, 2006, available at <http://www.law.com/jsp/article.jsp?id=1153904731954>. This article discusses the necessity of proving intent to defraud in securities fraud cases and argues persuasively that proof of backdating options, even if accompanied by evidence of falsification of a company’s books and records, does not establish securities fraud. For fraud, there must be an allegation of intent to harm someone; here, as the government concedes, the intent behind all option grants at issue was to attract and retain employees in a competitive job market, not to injure or harm anyone. (See Aff. ¶ 7).

Gregory L. Reyes, the former CEO of Brocade Communications, Inc. (“Brocade”), and Stephanie Jensen, the former Vice President of Human Resources, with one count of criminal securities fraud under 15 U.S.C. §§ 78j(b) and 78ff. In support of the complaint, the government filed the affidavit of Special Agent Joseph Schadler of the Federal Bureau of Investigation. (Aff. ¶ 3). Agent Schadler’s affidavit is based not on his personal knowledge, but on information purportedly obtained from documents and witnesses, all of whom are unidentified, and some of whom are second- or third-hand hearsay witnesses. (Aff. ¶¶ 3, 25).

On the same day, a criminal summons was issued on the basis of the complaint. The summons requires Mr. Reyes to appear before this Court to answer the government’s charges.

IV. ARGUMENT

A. **The government’s complaint is insufficient to support the summons because it fails to allege facts supporting “probable cause” of criminal intent.**

Despite the requirement that a criminal complaint contain all “essential facts,” the government’s complaint and accompanying affidavit are devoid of facts establishing the essential element of criminal intent. Under the Federal Rules of Criminal Procedure, a complaint must set forth “essential facts constituting the offense charged.” Fed. R. Crim. P. 3; Giordenello, 357 U.S. at 485, 84 S. Ct. at 1509; see also United States ex rel. Spader v. Wilentz, 25 F.R.D. 492, 494 (D.N.J. 1960), aff’d 280 F.2d 422 (3d Cir. 1960) (“It is equally essential that the complaint set forth with particularity the facts alleged to constitute a crime.”). Naturally, this requirement obligates the government to state facts “establish[ing] whether probable cause exists as to each required element” of the charged offense, including intent. In re Extradition of Platko, 213 F. Supp. 2d 1229, 1240 (S.D. Cal. 2002) (requiring complaint charging fraud to state facts showing fraudulent intent).

1 To establish criminal intent, the government must show that Mr. Reyes “willfully”
 2 violated the antifraud provisions of the federal securities laws. 15 U.S.C. § 78ff(a)
 3 (requiring “willful” violation to impose criminal liability); 15 U.S.C. § 77x (same); see
 4 also United States v. O’Hagan, 521 U.S. 642, 665-6, 117 S. Ct. 2199, 2214, 138 L. Ed. 2d
 5 724 (1997) (“To establish a criminal violation of Rule 10b-5, the Government must prove
 6 that a person ‘willfully’ violated the provision. Furthermore, a defendant may not be
 7 imprisoned for violating Rule 10b-5 if he proves that he had no knowledge of the rule.”)
 8 (citation and footnote omitted). At minimum, a “wilful” violation requires that “a person
 9 act[] knowingly with respect to the material elements of the offense.” Model Penal Code §
 10 2.02(8); see also United States v. Tarallo, No. 02-50252, 2005 U.S. App. LEXIS 12903
 11 (9th Cir. June 29, 2005).

12 While Section 10(b) may be characterized as a “catchall” fraud provision under the
 13 federal securities laws, “what it catches must be fraud.” Chiarella v. United States, 445
 14 U.S. 222, 234-235, 100 S. Ct. 1108, 1118, 63 L. Ed. 2d 348 (1980). In this case, the
 15 material elements are well-established and stated in Exhibit 2 of the affidavit: a violation
 16 requires that Mr. Reyes (1) made or caused Brocade to make a misstatement or omission,
 17 (2) of a material fact; (3) with scienter (that is, “willfully”); and (4) in connection with the
 18 purchase or sale of a security.

19 The government’s complaint contains fatal deficiencies in this regard. Although
 20 the supporting affidavit states in conclusory fashion that “Reyes ... did knowingly and
 21 willfully” commit securities fraud (Aff. ¶ 2), **it sets forth no facts corroborating this**
 22 **statement.** As the Supreme Court held in Gates, “a mere conclusory statement that gives
 23 the magistrate virtually no basis at all for making a judgment” is insufficient to establish
 24 probable cause. Gates, 462 U.S. at 239, 103 S. Ct. at 2332-33.

25 Read liberally, the affidavit sets forth factual assertions (albeit through unnamed
 26 hearsay witnesses) related to (1) Mr. Reyes’s purported knowledge that Board minutes had
 27 been allegedly backdated (Aff. ¶ 25); (2) Mr. Reyes’s purported knowledge that the dates
 28

on offer letters had been allegedly backdated (Aff. ¶¶ 28-35); and (3) Mr. Reyes's purported understanding that in-the-money options had "accounting implications" (Aff. ¶ 38).³ **Entirely absent are facts suggesting willful intent to misstate Brocade's financial statements, or to injure or harm anyone.** Indeed, conspicuous by their absence are facts suggesting that Mr. Reyes: (1) knew that Brocade's internal accounting for any alleged in-the-money options was incorrect; (2) knew that the accounting errors, if publicly reported, would represent misstatements in connection with the purchase or sale of Brocade's shares; or (3) knew that such alleged misstatements were even "material" to Brocade's financial statements. Allegations that Mr. Reyes had a general understanding of the "accounting implications" of stock-option grants (Aff. ¶ 38) are far too vague to satisfy the Giordenello specificity requirements, and fall far short of demonstrating knowledge sufficient to willfully manipulate complex option-accounting rules. Without such facts setting forth willful intent, the government's complaint fails to state "essential facts" constituting the offense. An order dismissing the complaint is therefore appropriate.

B. The government's complaint is insufficient because it fails to set forth the substance of documents or witness interviews relied upon.

Throughout its complaint, the government relies heavily on unidentified documents and unnamed witnesses. (See, e.g., Aff. ¶¶ 25, 28, 37) While the government is not obligated to identify these sources, it must set forth the substance of documents and witness interviews upon which it relies to establish probable cause. See Greenberg, 320 F.2d at 472 (finding complaint insufficient where affidavit fails to set forth information obtained in interviews or disclosed in public records); see also United States v. Barbanell, 231 F. Supp. 200, 202-03 (S.D.N.Y. 1964) ("[I]nvalid are complaints which are merely general conclusory statements that knowledge was gained through official investigations,

³ These purported facts may be relevant to the issue of whether there was a non-criminal books and records violation under section 13(b)(2) of the Exchange Act, 15 U.S.C. § 78m(b)(2), but they are a far cry from allegations of fraud.

1 third-party statements or reports without specifying what the investigations showed or
2 what the reports and statements indicate.”) (emphasis added).

3 Like the affidavit in support of the complaint which was dismissed in Greenberg,
4 the government’s affidavit states obliquely that “[t]he following is based on [the affiant’s]
5 review of e-mails and witness interviews,”⁴ but never sets forth what the e-mails disclosed
6 or what the witnesses said. (Aff. ¶ 25). Instead, the affidavit includes only the conclusory
7 inferences of the affiant, providing no basis for an independent assessment. Such
8 conclusory statements “give[] the magistrate virtually no basis at all for making a
9 judgment regarding probable cause” and therefore cannot support the issuance of the
10 summons. See Gates, 462 U.S. at 239, 103 S. Ct. at 2332-33.

11 All of the complaint’s backdating allegations are conclusory in nature and
12 purportedly rely on the unspecified contents of unidentified evidence. For example, in
13 paragraph 25 et seq., the affiant claims that on the basis of his “review of e-mails and
14 witness interviews I have conducted ... REYES and JENSEN backdated” certain
15 compensation committee meeting minutes. But nowhere does the complaint set forth the
16 substance of the e-mails or witness conversations raising this inference. In paragraph 28,
17 the complaint states simply that “documentary evidence and witness statements also
18 indicate that REYES and JENSEN caused employment records and similar records to be
19 backdated.” But, here again, the complaint fails to state how the documentary evidence or
20 witness statements support the affiant’s conclusion. Again in paragraph 37, the affiant
21 states in conclusory fashion that “[t]he documents that I have reviewed and the witness
22 statements indicate that REYES and JENSEN knew that the backdated Committee meeting
23 minutes and similar documents were provided to Brocade’s finance department and

24 _____
25 ⁴ Also, the complaint in Greenberg stated that the investigator uncovered his
26 findings “by examination of [Hayman Greenberg’s] tax records, by identifying and
27 interviewing third parties with whom the said taxpayer did business; by consulting with
28 public and private records reflecting the said taxpayer’s income; and by interviewing third
persons having knowledge of the said taxpayer’s financial condition.” 320 F.2d at 468-69.
The Ninth Circuit affirmed the ruling of the district court which found the complaint
insufficient to demonstrate probable cause.

1 outside auditors.”⁵ Any basis for this statement is no where to be found within the
2 affidavit’s four corners.

3 Absent any such specification, the inference of probable cause “will be drawn not
4 ‘by a neutral and detached magistrate,’ as the Constitution requires, but instead, by a
5 police officer ‘engaged in the often competitive enterprise of ferreting out crime.’”
6 Aguilar, 378 U.S. at 114-115, 845 S. Ct. at 1514 (quoting Giordenello, 357 U.S. at 436, 78
7 S. Ct. at 1250). The Fourth Amendment forbids this result. As such, the government’s
8 complaint must be dismissed, and the summons invalidated.

9
10 **C. The government’s complaint is insufficient because it fails to establish
the veracity or reliability of unidentified hearsay witnesses.**

11 The government bases nearly all of its allegations on hearsay — and often double-
12 hearsay —information. (See, e.g., Aff. ¶¶ 25, 27, 28, 35, 37, 38). Though the federal rules
13 permit the use of hearsay in this context, the government must demonstrate a “substantial
14 basis for crediting the hearsay presented.” Jones v. United States, 362 U.S. 257, 269, 80
15 S. Ct. 725, 735, 4 L. Ed. 697 (1960); see Aguilar, 378 U.S. at 114-115, 84 S. Ct. at 1514.
16 (“[T]he magistrate must be informed of the ... underlying circumstances” based on which
17 “the officer concluded the informant was credible ... or reliable.”); Spinnelli v. United
18 States, 393 U.S. 410, 89 S. Ct. 584, 21 L. Ed. 2d 637 (1969) (finding complaint
19 insufficient where affidavit described informant as reliable but gave no reason in support
20 of that conclusion). Such evidence is particularly important where a witness has
21 motivation to lie, such as a desire to “spread[] the blame for the crime.” See Hale v. Fish,
22 899 F.2d 390, 399 n.1 (5th Cir. 1990); see also Morin v. Caire, 77 F.3d 116, 122 (5th Cir.
23 1996) (“[A] warrant affidavit must include information regarding an informant’s veracity
24 in cases in which the informant has an incentive to lie.”).

25
26 ⁵ In the government’s few attempts to set forth the contents of documents or
27 witness interviews, the information purportedly disclosed is entirely innocuous and fails to
28 support the affiant’s fraud allegations. For example, in paragraph 29, the affiant states that
“documents and witnesses statements show that at the end of January 2002, Employee One
was recruited by Brocade to a high level sales position.” (Aff. ¶ 29).

1 Despite the ubiquitous use of hearsay to support its claims, the affidavit fails to
2 assert any facts relating to the reliability or veracity of the hearsay information. In most
3 cases, the affidavit states that the affiant's conclusions are based on witnesses interviews
4 and e-mails, without further comment on the reliability of those sources. (Aff. ¶ 25, 28).
5 For example, the affiant fails to set forth any facts regarding the basis for the witnesses'
6 purported knowledge, such as the degree of interaction, if any, with Mr. Reyes. In other
7 instances, the complaint sets forth unsubstantiated single- and double-hearsay where the
8 sources have obvious motivation to lie.

9 For example, on two occasions, the complaint cites interviews conducted as part of
10 the internal investigation by Brocade's Audit Committee. (Aff. ¶ 27, 38). The affiant did
11 not attend these interviews, and presents no information to the Court regarding the
12 circumstances or the reliability of the interviews. Indeed, the affidavit fails to offer any
13 reasons why the magistrate should credit the hearsay reported by the Audit Committee's
14 investigation.

15 Similarly, the affidavit claims that witnesses "have stated that they told REYES
16 and JENSEN that Brocade would incur a compensation expense if it granted in-the-money
17 stock options." (Aff. ¶ 37). However, the affidavit offers no evidence of the **reliability** or
18 **veracity** of those witnesses, or the context in which the alleged statements were
19 purportedly made. For example, the affiant does not even specify whether the purported
20 discussions occurred during the time of the alleged backdating. Absent such evidence, the
21 Court has no basis to evaluate the trustworthiness of the information.

22 There is yet another reason to doubt the reliability of the witnesses testimony with
23 regard to the government's backdating allegations: as the sole member of Brocade's
24 compensation committee (Aff. ¶ 18), only Mr. Reyes knew the dates on which he elected
25 to grant options. Indeed, very few employees were even aware that the Company's board
26 of directors had delegated this level of authority to Mr. Reyes. For this reason, employee
27 witnesses can only **speculate** about the timing of option grants and whether documents
28

1 were truly “backdated,” as the affiant concludes, or simply dated to reflect the actual
2 timing of Mr. Reyes’s option-grant decisions. Yet despite these facts – perhaps because of
3 these facts – the affidavit offers no basis to credit the testimony of these witnesses.

4 In addition, the affidavit lacks any statement as to whether these purported
5 witnesses have received any benefit, like a promise of non-prosecution, or a witness letter,
6 from the government. By omitting this information, the government excludes essential
7 facts necessary to evaluate the witnesses’ reliability.

8 Like the affidavit’s other infirmities noted above, this deficiency relates to the
9 complaint’s core allegations: specifically, Mr. Reyes’s participation in the alleged
10 backdating of various documents, and his alleged knowledge of “accounting implications.”
11 Stripped of these unsubstantiated allegations, the complaint is bare of any “essential facts”
12 upon which a finding of probable cause could conceivably be based. For this reason, the
13 complaint and accompanying affidavit is insufficient, and the criminal summons invalid.

14 **V. REQUEST FOR EXPEDITED PRELIMINARY HEARING**

15 For the reasons stated above, we believe the law requires dismissal of the
16 government’s complaint. If the Court nonetheless declines to dismiss the complaint,
17 Mr. Reyes respectfully requests an expedited preliminary hearing date to determine
18 probable cause. We believe an expedited hearing is necessary to safeguard Mr. Reyes’s
19 Fourth Amendment interests, particularly in light of the government’s zealous efforts to
20 publicize its allegations. Given the insufficiency of the government’s complaint, and the
21 ongoing reputational harm inflicted by the government’s public-relations initiatives, we
22 respectfully request an expedited preliminary hearing. We are prepared to go forward with
23 the preliminary hearing at the Court’s earliest convenience.

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VI. CONCLUSION

As stated, the government's complaint is insufficient for three reasons.

- The complaint fails to state the essential facts constituting the crime charged: most notably, facts relating to the existence of criminal intent.
- The complaint fails to specify the contents of documents or substance of interviews that purportedly form the basis of its assertions.
- The complaint fails to offer any facts relating the reliability of hearsay information, which supports all of its core allegations.

The complaint should therefore be dismissed and the summons deemed invalid.

DATED: July 27, 2006

Respectfully submitted,

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