

Criminal charges filed against ex-Brocade CEO

Gregory Reyes and other former execs have been indicted in connection with backdating of stock options.



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SAN FRANCISCO--In a case with far-reaching implications for Silicon Valley, former top executives of Brocade Communications Systems are facing civil and criminal charges relating to allegations of stock option backdating.

Federal officials announced the charges against Gregory Reyes, Brocade's chief executive until 2005, and Stephanie Jensen, the company's vice president of human resources from 1999 to 2004, at a press conference here on Thursday.

The widely anticipated charges are the first in what could be a number of prosecutions of Northern California companies and their executives related to stock option backdating, which is illegal in some circumstances. The Securities and Exchange Commission says it has more than 80 active investigations nationwide.

Fraud relating to stock option grants "goes to the heart of the relationship between a corporation and its shareholders," said SEC Chairman Christopher Cox. The SEC has filed civil charges against Reyes, Jensen and Antonio Canova, Brocade's former chief financial officer.

Reyes is innocent and has done nothing wrong, said his attorney, [Richard Marmaro](#), a partner at Skadden, Arps, Slate, Meagher & Flom who specializes in white-collar defense.

Marmaro sent a statement to reporters saying that "financial gain is always the motive in securities fraud cases, and here there was none. There is not even an allegation of self-enrichment, or self-dealing."

An affidavit filed by the FBI in the northern district of California on Thursday does not accuse Reyes of personally profiting from stock option backdating. Instead, the FBI claims, Reyes and other executives backdated stock options to attract and retain key employees.

To lure an unnamed employee for a "high-level sales position," the affidavit says, Reyes told Jensen to backdate an offer letter by more than two months to benefit from a more favorable share price in late 2001.

In its own statement on Thursday, Brocade noted that no executives "involved in the historical stock option granting practices remain" with the company.

The San Jose-based networking gear maker also said it has reserved \$7 million for a proposed settlement with the SEC. Shares of Brocade, which restated its financial results twice during 2005, closed down 1.8 percent at \$5.91.

The press conference comes a week after U.S. Attorney Kevin Ryan [announced the formation of a joint task force](#) that he said would "bring criminal charges when appropriate" against Northern California companies that engaged in unlawful stock option backdating.

Allegations about stock option backdating, which is not necessarily illegal, have ensnared dozens of companies and drawn the attention of securities regulators and plaintiffs' lawyers.

Stock option recipients have the right to buy a share of a company's stock at a price called the strike price, the value of the stock on a certain date. If the strike price is \$10 and the shares now trade at \$15, each option would be worth \$5. (The options would be worthless if the stock fell below \$10.)

If an executive is able to change the date retroactively--for instance, to when the stock was trading at a lower price--the options would become more lucrative.

That's precisely what federal investigators are looking into. Some academic research has suggested that many companies have engaged in the practice--which could be a securities fraud violation if the disclosures accompanying stock option grants were intentionally misleading. Tax laws could also be triggered because of different rates for deducting different types of stock options.

George Stamboulidis, a former Justice Department prosecutor who's now a partner at the Baker Hostetler law firm in New York, said he expects more criminal charges to be announced soon against other companies.

Stamboulidis said other cases are more likely to yield allegations of personal profiteering by chief executives. "We've seen some of the reports of cases when multiple millions of dollars have been made by executives including the CEOs," he said.

In the case against Brocade's Reyes and Jensen, Stamboulidis said that it was odd for the Justice Department not to seek a grand jury indictment immediately. The method prosecutors chose instead made information in an FBI affidavit public, which could "soften up the defendant" and make them more amenable to cooperating, he said.