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How the Broadcom Backdating Case Went Awry

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By Peter J. Henning

The revelation back in 2006 that a number of companies had backdated their stock option grants set off a number of internal inquiries and a slew of investigations by the Securities and Exchange Commission. What was once viewed as the next wave of securities fraud cases ultimately resulted in a number of settlements with the S.E.C., and along the way the Justice Department obtained a few criminal indictments for unlucky executives who caught the eyes of federal prosecutors.

Among those targeted for prosecution were senior executives at the semiconductor manufacturer Broadcom, the networking company Brocade Communications, the Internet security provider McAfee and the software company Comverse Technology. These cases, however, have not turned out as well as prosecutors might have hoped.

The United States Court of Appeals for the Ninth Circuit has reversed the conviction of Brocade's former chief executive, Gregory Reyes, for his role in backdating options because of prosecutorial misconduct in presenting incomplete information to the jury. McAfee's former general counsel, Kent Roberts, was acquitted by a jury because of a lack of evidence of his intent to commit securities fraud. Comverse's former chief executive, Kobi Alexander, skipped the country shortly before his indictment and is now living in Namibia, fighting extradition proceedings to return him to the United States to face the charges.

The prosecution of three Broadcom executives for backdating has developed into one of the strangest white-collar crime cases in years. The government indicted the company's former chairman, Henry Samueli, owner of the National Hockey League's Anaheim Ducks; the former chief executive, Henry Nicholas, who has also been charged with drug violations, and the former chief financial officer, William Ruehle. Mr. Samueli entered a guilty plea to one count of falsely testifying before the S.E.C. about the backdating, while Mr. Nicholas and Mr. Ruehle chose to fight the charges.

Mr. Ruehle's case came to trial first, but not before Judge Cormac J. Carney of Federal District Court in Santa Ana, Calif., tried to preclude the government from using statements Mr. Ruehle made to Broadcom's corporate counsel during its internal investigation of the options backdating. Judge Carney found that Mr. Ruehle was also represented by the same law firm, Irell & Manella, in related civil actions, so that any statements he made to the lawyers were protected by the attorney-client privilege and should not have been disclosed to the government. The Ninth Circuit rejected that position, finding that Mr. Ruehle's statements were not made in confidence to the company's lawyers, so the company could turn them over to prosecutors.

Fresh off that initial victory, it looked like the government's case would go well, but serious problems developed at trial. Two witnesses the defense wanted to call were Mr. Samueli and Broadcom's former general counsel, David Dull, to testify that they were not aware of any problems in the options grants. Unfortunately for Mr. Ruehle, both men indicated that they would assert their Fifth Amendment privilege unless the government granted them immunity, which prosecutors refused to do.

Mr. Dull had never been charged in the criminal case, but he was sued for securities fraud by the S.E.C. and testified in that case that he did not believe the options were improperly backdated. Mr. Samueli took the same position regarding the propriety of the options grants and contended that the government's unfair treatment of him forced the guilty plea. Mr. Ruehle asked the court to grant immunity to the two witnesses so that he could mount a defense that he did not intend to defraud the company or its investors.

The primary federal statute on immunity, 18 U.S.C. § 6002, requires a government request before the court can grant immunity, and courts are generally loathe to undermine a criminal case by immunizing a potentially culpable person. It is rare that a court will grant immunity to a defense witness without the government's acquiescence. A number of defendants have complained on appeal that the government's refusal to give immunity to defense witnesses unduly hampered their defense, including WorldCom's former chief executive, Bernie Ebbers, and Enron's former chief executive, Jeffrey Skilling. Those claims usually fall on deaf ears, however, and rarely is a conviction overturned for failure to immunize a prospective defense witness.

There is one ground on which a judge can grant immunity without prosecutorial approval, if it appears the government is trying to hide relevant evidence from the jury. Like a violation of the duty to turn over exculpatory evidence to a defendant, required by the Supreme Court's decision in *Brady v. Maryland*, a court has the authority to ensure due process by granting immunity on its own so that all relevant evidence comes before the jury. Judge Carney issued immunity orders for Mr. Samueli and Mr. Dull that allowed them to testify for Mr. Ruehle, a rare victory for a defendant that would have a significant impact on the trial.

The government then shot itself in the foot shortly after the judge issued the immunity order to Mr. Dull. One of the federal prosecutors contacted Mr. Dull's lawyers and told them that if their client testified in the same way he did before the S.E.C. in its civil case, he would be committing perjury — a not-so-subtle threat to prosecute him. According to Mr. Dull's lawyers, the prosecutor then said that if Mr. Dull would testify that he had lost faith in Mr. Ruehle's integrity, the government would go "soft" on the cross-examination.

The conversation was quickly reported to Judge Carney, who — not surprisingly — hit the roof at this prosecutorial misconduct that sought to intimidate Mr. Dull and have him shape his testimony in a way that favored the government. This is the same prosecutor who later admitted he leaked information to the news media about Mr. Samueli's lack of cooperation in the investigation. That type of disclosure violates one of the most important rules of criminal procedure, that all information about matters occurring before the grand jury remain secret.

The government's case went from bad to worse after Mr. Samueli testified for the defense. Judge Carney had accepted his guilty plea to lying to the S.E.C., but withheld sentencing until he saw how the cases against Mr. Ruehle and Mr. Nicholas went. After listening to Mr. Samueli's testimony, the judge dismissed the charge against him, finding that while he might not have been completely forthcoming to the S.E.C., he did not lie and so committed no crime. Judge Carney also said he was "a little bit disturbed by the way the government treated you," and even informed the jury about the dismissal, no doubt bolstering Mr. Samueli's credibility in their eyes.

Much like the immunity grants, dismissing a charge after accepting a defendant's guilty plea is almost unheard of. Doing so because the person's testimony on behalf of another defendant appeared truthful is all the more rare. But it is clear Judge Carney has decided the government acted improperly, so the defendants are getting all the breaks. Prosecutors can appeal the dismissal of Mr. Samueli's guilty plea, but it may be difficult to overturn based on the judge's conclusion that the statements did not constitute lying, which is required for a conviction.

As one might expect, the defense case went quite well once the two immunized witnesses told the jury that they didn't think the options grants were improper. Mr. Ruehle didn't testify because Mr. Samueli and Mr. Dull did the work for him. While a defendant's decision not to testify can cause a jury to wonder what the person is hiding, in this case it was clearly the wise choice because there was no need to open him up to cross-examination when two of Broadcom's senior officers provided the jury with all the defense needed to make its case.

Judge Carney scheduled closing statements for Thursday, but before then — on Tuesday — he will consider a defense request to enter a judgment of acquittal because of insufficient evidence of intent and prosecutorial misconduct. Given how the case has gone to this point, I think there is a decent chance the judge will grant the motion — once again, a rarity in a criminal trial. That would end the case because under the Double Jeopardy Clause the government cannot appeal the grant of an acquittal motion if it is given during the trial before the jury returns its verdict.

Even if the court denies Mr. Ruehle's acquittal motion, the odds of the government securing a conviction are pretty low. Juries often take their cues from the judge, and it is clear how Judge Carney feels about the government's case, so don't be surprised if the jury returns a "not guilty" verdict.

The government's record in the criminal options backdating cases has not been stellar, and another acquittal would show how hard it is to prosecute senior executives for conduct that, while questionable, is not clearly criminal in nature. Options backdating has always been fairly well removed from the typical securities fraud involving falsified accounting records or insider trading, the type of conduct that juries can easily see is improper.

Mr. Nicholas, the former Broadcom chief executive, will take heart from Mr. Ruehle's trial because Mr. Dull and Mr. Samueli can also testify on his behalf. Maybe Kobi Alexander, the former Comverse chief executive, should consider returning from Namibia to face the charges.

Update: Dec. 15, 1:37 p.m. Citing prosecutorial misconduct, a federal judge dismissed fraud charges against a founder of Broadcom and its former chief financial officer.