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U.S. v. Goyal: Stretching The Criminal Law Beyond Its Normal Bounds

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To most it's an obvious point: The purview of criminal law should be limited to criminal conduct. Yet that point maybe lost on some since, as Chief Judge Alex Kozinski points out, *United States v. Goyal,* No. 08-10436 (9th Cir. Dec. 10, 2010) is just the latest in a "string of recent cases in which courts have found that federal prosecutors overreached by trying to stretch criminal law beyond its proper bounds." *Id.* at 19761-19762. It is no surprise then that in Goyal the U.S. Court of Appeals for the Ninth Circuit reversed the defendant's convictions, and Judge Kozinski took the opportunity to rebuke the government with a simple message: Prosecutors should not bring criminal charges unless they have clear evidence of *criminal* wrongdoing.

Goyal involved charges of securities fraud and making materially false statements to auditors against Prabhat Goyal, who from 1997 to 2001 served as the chief financial officer of the popular anti-virus software company Network Associates, Inc. (NAI). The government alleged that while under Goyal's supervision, NAI violated generally accepted accounting principles (GAAP) by recognizing revenue from certain software sales earlier than it should have. It indicted Goyal for concealing the allegedly improper accounting from NAI's outside auditors and for filing false reports with the Securities and Exchange Commission (SEC).

The charges stem from developments beginning in 1998 when, in an effort to boost its quarter-end sales projections, NAI negotiated deals with its distributors known as "buy-in" transactions. Under buy-in transactions, which are commonly used in the software industry, NAI provides lucrative financial incentives to its distributors in return for agreements to purchase its software. The distributors then resell NAI's software to retailers, who in turn sell the software to end users.

The government never claimed that buy-in transactions were illegal. Rather, the government took issue with the accounting method NAI used to recognize revenue from its buy-in sales. In particular, prosecutors objected to the use of "sell-in" accounting with NAI's largest domestic distributor, Ingram Micro (Ingram). Under sell-in accounting, NAI recognizes revenue when it ships its software to Ingram, and then subtracts from that amount estimates of the amount of future rebates, discounts, or returns. Prosecutors claimed that sell-in accounting recognized revenue too early in the buy-in transaction and thus resulted in NAI overstating its revenue. By contrast, the government contended that NAI should have reported the Ingram figures using the more conservative "sell-through" accounting, which recognizes revenue when Ingram sells NAI's software to retailers.

Accepting the government's argument, a jury convicted Goyal of one count of securities fraud, seven counts of making false filings with the SEC, and seven counts of making materially false statements to NAI's auditors. Following unsuccessful motions for judgment of acquittal and for a new trial, Goyal appealed.

On appeal, a unanimous Ninth Circuit panel reversed Goyal's convictions on all counts, finding that based on the evidence the prosecution presented at trial, no jury could have found him guilty beyond a reasonable doubt.

Regarding the eight securities counts, the court found that the government failed to prove that NAI materially misstated its revenue by selecting sell-in accounting to report its figures. The court explained that though the government relied on stipulations that applying sell-through accounting to NAI's entire business would have resulted in revenue reports that were materially less than the reported figure, the government never once contended that GAAP required NAI to use sell-through accounting for all its sales. Instead, the government claimed that GAAP only required sell-through for the Ingram buy-in transactions. Accordingly, the government failed to produce any evidence that sell-in accounting, rather than sell-through, on the Ingram transactions resulted in a material difference in the revenue NAI reported.

Moreover, with respect to the counts alleging false statements made to auditors, the court held that the government failed to prove that Goyal made willfully false statements in management representation letters to its auditors that: (1) NAI's financial statements complied with GAAP and (2) that NAI had disclosed all "sales terms." First, the court found that the government failed to provide evidence for all but one count that NAI's financial statements violated GAAP. Second, even where there was evidence that Goyal made false statements to auditors about GAAP or its sale terms, the court held that there was no evidence that Goyal made such statements *willfully*. To conclude otherwise, the court stated, would place a strict-liability standard on a charge that requires willful and knowing deception and make Goyal criminally responsible for a perceived mistake.

In an impassioned concurrence, Judge Kozinski took the prosecution to task for what he described as consuming an inordinate amount of taxpayer resources and devastating Goyal's personal and professional life without proving that he engaged in any criminal conduct. Judge Kozinski admonished the government, stating that the role of criminal law is to punish those acts that communities decide warrant moral condemnation. But when, as here, the prosecutors have to stretch the law or the evidence to secure a conviction, he notes such moral judgment is hardly warranted.

Make no mistake, Judge Kozinski acknowledged that Goyal is one of the lucky ones; he benefited from access to exceptional counsel and is spared the punishment for a crime he did not commit. But Kozinski also recognizes that Goyal's case is illustrative of a problem precipitating in the criminal courts: Increasingly, prosecutorial discretion is blinded by a desire to secure convictions.

The majority points out that general financial incentives that merely reinforce a CFO's preexisting duties to maximize a company's performance cannot be inherently probative of fraud. Yet those financial motives--and not criminal conduct--seem to be precisely what prosecutors took issue with here. The government charged Goyal with crimes for business decisions he made to maximize profits for his company--decisions that were entirely consistent with industry practice and consistent with the law. The court, however, sent a clear message to prosecutors to, put it lightly, exercise greater caution before bringing such charges in the future.

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