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KEVIN V. RYAN (CSBN 79002)
United States Attorney

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CLERK, U.S. DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

**SEALED
BY COURT ORDER**

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

CR 03 0172

UNITED STATES OF AMERICA,
Plaintiff,
v.
TERRY W. DAVIS,
Defendant.

No. **PJH**
VIOLATION: Securities Fraud – 15 U.S.C. § 78j(b) and 78ff, and 17 C.F.R. § 240.10b-5; Aiding and Abetting – 18 U.S.C. § 2
SAN FRANCISCO VENUE

INFORMATION

The United States Attorney charges:

I. BACKGROUND

At all times relevant to this Information:

A. The Company

1. Network Associates, Inc., (“Network Associates”), a Delaware corporation with principal offices in Santa Clara, California, manufactured and sold computer programs (“software”) and hardware relating to computer network security and management. Network Associates’ fiscal year ended on December 31. Network Associates’ independent auditor was PriceWaterhouseCoopers.

2. Network Associates was a publicly traded company whose stock was registered with

INFORMATION

1 the Securities and Exchange Commission (the "SEC") pursuant to Section 12(b) of the Securities
2 Exchange Act of 1934. Network Associates' shares originally traded on the National Association
3 of Securities Dealers Automated Quotation System ("NASDAQ") under the symbol "NETA."
4 On February 12, 2002, Network Associates' shares began trading on the New York Stock
5 Exchange under the symbol "NET."

6 3. As a public company, Network Associates was required to comply with regulations of
7 the SEC. Those regulations are designed to protect members of the investing public by, among
8 other things, ensuring that a company's financial information is accurately recorded and
9 disclosed to the public.

10 4. Under SEC regulations, Network Associates and its officers had a duty to: (a) make
11 and keep books, records and accounts that fairly and accurately reflected the company's business
12 transactions; (b) devise and maintain a system of internal accounting controls sufficient to
13 provide reasonable assurances that the company's transactions were recorded as necessary to
14 permit preparation of financial statements in conformity with Generally Accepted Accounting
15 Principles ("GAAP"); and (c) file quarterly reports (Form 10-Q) and annual reports (Form 10-K)
16 which included reliable financial statements. The Forms 10-Q required unaudited financial
17 statements, and the Forms 10-K required audited financial statements.

18 B. The Defendant

19 5. Terry W. Davis began working in the tax department at Network General Corporation,
20 Network Associates' predecessor corporation, in September 1992, and was named its Corporate
21 Tax Director in 1997. In December 1997, Network General and McAfee Associates, Inc.,
22 combined to form Network Associates, and Davis remained in the merged corporation as
23 Network Associates' Corporate Tax Director. In September 1999, Davis was promoted to Vice
24 President and Corporate Controller. In July 2000, Davis was given the added title of Senior Vice
25 President of Corporate Finance. From January to April 2001, Davis served as acting Chief
26 Financial Officer. After April 2001, Davis remained Controller and Senior Vice President of
27 Corporate Finance until his termination on April 24, 2002.

28 //

1 the fourth quarter of 2000.

2 10. The means and methods by which the defendant and others achieved and attempted
3 to achieve the goals of the scheme included:

- 4 a. Selling more products into the channel to distributors who were already
5 holding millions of dollars of excess inventory of Network Associates'
6 products;
- 7 b. Making payments to distributors disguised as discounts, rebates and
8 marketing fees in order to convince them to hold excess inventory, not
9 return unsold products, and purchase more products than they could
10 actually sell to customers during a given quarter;
- 11 c. Granting to distributors special terms and conditions that were usually
12 reflected in oral and written side agreements, and which, if disclosed to
13 auditors, would have negated immediate recognition of revenue under
14 GAAP;
- 15 d. Making fraudulent entries in Network Associates' books and records;
- 16 e. Concealing the true nature and source of the improper payments from
17 Network Associates' outside auditors;
- 18 f. Making false statements and material omissions to outside auditors;
- 19 g. Filing materially false and misleading financial statements with the SEC;
- 20 h. Making materially false and misleading public statements about Network
21 Associates' financial performance; and
- 22 i. In effect, directly assisting distributors in the resale of Network
23 Associates' products by using a subsidiary shell company wholly owned
24 by Network Associates, Net Tools, Inc., to buy products Network
25 Associates had previously sold to its distributors and thus reduce high
26 distributor inventory levels, avoid product returns, and resultant reduction
27 in revenue.

1 B. Disguised Payments and Discounts to Distributors

2 11. During the fourth quarter of 1999, Davis and others paid one of Network Associate's
3 principal customers, a large software distributor, over \$21 million in eight separate wire
4 transfers. Davis and others falsely described these payments as reimbursement for "marketing
5 fund rebates and other promotional programs." In fact, these payments were intended to
6 compensate the distributor for, among other things, agreeing to a new buy-in letter and not
7 returning excess inventory for a refund. By disguising these payments, Davis and others
8 convinced Network Associates' auditors that these payments were marketing and other expenses
9 rather than discounts. As a result, Network Associates' financial statements were materially
10 incorrect because these expenses should have been deducted from revenue instead of recorded as
11 marketing and other business expenses.

12 12. In September and October 2000, Davis and others authorized additional payments
13 totaling approximately \$27 million to the same large software distributor referred to in paragraph
14 11 above. Davis and others again falsely mischaracterized these payments to auditors as "market
15 development funds," "promotional programs," and "early payment of invoices" in order to
16 persuade the auditors not to deduct the payments from revenues.

17 13. At the end of the first quarter of 2000, the same large software distributor referred in
18 paragraph 11, above, demanded an "excess inventory fee" of two percent for holding and not
19 returning over \$54 million of Network Associates' products as a condition to agreeing to a new
20 buy-in agreement. In a March 8, 2000 "side letter," Davis and others agreed to pay the
21 distributor approximately \$1.1 million as a "non-refundable debit for excess inventory." With
22 these and other substantial discounts and rebates, the distributor then agreed to a new buy-in
23 letter for the quarter.

24 14. In June 2000, the same large software distributor again demanded an "excess
25 inventory fee" for holding and not returning over \$65 million of Network Associates' products as
26 a condition to agreeing to a new buy-in letter. At that time, the distributor estimated that, if it
27 agreed to a new buy-in letter, it would hold over 22 months of Network Associates' products in
28 inventory. Davis and others eventually agreed to pay the distributor a three percent excess

1 inventory fee of approximately \$1.9 million. Davis and others also agreed to pay the distributor
2 an additional three percent fee, totaling \$750,000, in exchange for the distributor's payment of
3 approximately \$25 million owed to Network Associates from an earlier buy-in. Network
4 Associates' payments were sent with letters which falsely described the payments as
5 reimbursements "related to early payment of invoices," "meet comp promotional programs," and
6 "marketing and other promotional programs," so as to enable Network Associates to falsely
7 classify the payments as expenses and not deductions from revenue.

8 15. In September 2000, the same large software distributor again demanded an "excess
9 inventory fee" for holding and not returning over \$52 million of Network Associates' products as
10 a condition to agreeing to a new buy-in letter. Davis and others eventually agreed to pay a four
11 percent excess inventory fee of approximately \$2.1 million. Davis and others also agreed to pay
12 the distributor an additional five percent fee, totaling approximately \$1.65 million, in exchange
13 for the distributor's payment of approximately \$33 million owed to Network Associates from an
14 earlier buy-in letter. Network Associates' payments were sent with letters which again falsely
15 described the payments so as to enable Network Associates to falsely classify them as expenses
16 and not deductions from revenue.

17 C. False Accounting Entries

18 16. If the true nature of the payments described in paragraphs 11 through 15 above had
19 been disclosed to, and not concealed from, the company's auditors, Network Associates would
20 not have recognized these transactions as revenue reported to the investing public and the SEC.
21 The discounts, rebates, and payments Network Associates made to its distributors, and the
22 manner in which Network Associates accounted for these fees, violated provisions of GAAP,
23 which among other things, require that a sales price be fixed and determinable at the date of the
24 sale in order for the seller to recognize revenue. The sales price of these software license
25 transactions was not fixed and determinable at the time Network Associates' recognized revenue
26 because of the indefinite amount of product returns, excess inventory fees, discounts, and rebates
27 that Network Associates knew it would need to grant, and did grant, to its distributors for prior
28 software sales to convince these distributors to buy even more product at the end of each quarter.

1 17. Davis and others violated GAAP and SEC accounting rules by secretly using tax
2 reserve accounts to increase Network Associates' inadequate sales return reserves to, among
3 other things, cover the costs of the payments, rebates and discounts Network Associates made to
4 its distributors, as follows:

5 (a) In November 1999, Davis increased the company's sales return reserves by \$15
6 million through a fraudulent reduction in the tax reserve accounts.

7 (b) Thereafter, on or about November 30, 1999, Davis increased the company's sales
8 returns reserves to cover \$21.6 million in payments to the distributor through
9 multiple fraudulent reductions in the tax reserve accounts.

10 (c) On or about October 3, 2000, Davis increased the company's sales returns
11 reserves by approximately \$10 million by a fraudulent reduction in the tax reserve
12 accounts to cover returns by a distributor.

13 D. Insider Trading

14 18. Between February 26, 2002 and March 8, 2002, Davis exercised stock options and
15 sold 90,463 shares of Network Associates' common stock for net proceeds of approximately \$1.4
16 million. Davis made these trades on the basis of the material non-public information that
17 Network Associates' publicly reported financial statements were false and misleading and
18 materially misrepresented the company's revenues, expenses and net income.

19 COUNT ONE: (15 U.S.C. §§ 78j(b) and 78ff; 17 C.F.R. § 240.10b-5 – Securities Fraud;
20 18 U.S.C. § 2 - Aiding and Abetting)

21 19. Paragraphs 1 through 19 are incorporated here by reference.

22 20. Between in or about January 1998 and continuing to in or about January 2001, in the
23 Northern District of California, and elsewhere, the defendant

24 TERRY W. DAVIS

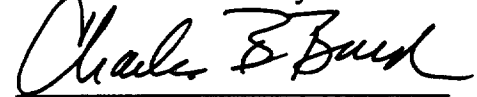
25 knowingly and willfully, directly and indirectly, by the use of the facilities of a national securities
26 exchange, to wit, NASDAQ, did use and employ manipulative and deceptive devices and
27 contrivances in connection with the purchase and sale of securities issued by Network
28 Associates, in violation of Title 17, Code of Federal Regulations, Section 240.10b-5, by (a)
employing a device, scheme and artifice to defraud in connection with the purchase and sale of


1 Network Associates securities; (b) making and causing to be made untrue, false and misleading
2 statements of material fact in reports and documents required to be filed under the Securities
3 Exchange Act of 1934 and the rules and regulations thereunder; (c) knowingly falsifying and
4 causing to be falsified Network Associates's books, records, and accounts; (d) knowingly
5 violating and causing to be violated Generally Accepted Accounting Principles and
6 circumventing and failing to implement a system of internal accounting procedures and controls;
7 (e) knowingly making and causing to be made materially false and misleading statements to
8 PriceWaterhouseCoopers in connection with its review of Network Associates' financial
9 statements and the preparation of the quarterly and annual reports required to be filed with the
10 SEC; and (f) personally profiting from the scheme to defraud by trading in Network Associates'
11 stock on the basis of material, non-public information.

12 All in violation of Title 15, United States Code, Sections 78j(b), and 78ff, and Title 17,
13 Code of Federal Regulations, Section 240.10b-5 and Title 18 United States Code, Section 2.

14
15 DATED: 6/5/03

KEVIN V. RYAN
United States Attorney


CHARLES B. BURCH

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19 Approved as to form: 
AUSAs: Choi/Bornstein

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