

**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION**

Securities and Exchange Commission,)	
)	
Plaintiff,)	
)	
vs.)	Civil Action No.
)	
Gary C. Gerhardt,)	
)	
)	Trial by Jury Demanded
Defendant.)	

COMPLAINT

Plaintiff, the United States Securities and Exchange Commission (“the Commission”), for its Complaint, alleges as follows:

SUMMARY

1. From 1997 through 2003, Gary C. Gerhardt participated in a fraudulent scheme intended to enrich certain officers, directors, and employees of Engineered Support Systems, Inc. (“Engineered Support” or “the Company”). Engineered Support’s management periodically issued stock options to officers, directors and certain employees as an incentive, purportedly tying the recipients’ compensation to the Company’s future stock price. Pursuant to Engineered Support’s stock option plans, the Company was required to grant these options “at-the-money,” which means that the option exercise price would be equal to the closing market price of the Company’s common stock on the date of the award. Thus, employees and directors would profit only if the Company’s stock price rose after options were awarded.

2. During this period of time, Engineered Support regularly issued proxy statements and annual reports which represented that the Company’s stock options were

issued with exercise prices equal to the closing market prices on the dates of the awards. However, these statements were false.

3. Gerhardt, who was Engineered Support's Chief Financial Officer ("CFO") during the relevant period, directed Steven Landmann ("Landmann"), his subordinate and Engineered Support's Controller, to backdate the grant dates of certain of Engineered Support's stock options to coincide with low points in the closing market price for the Company's common stock. This undisclosed practice resulted in grants of disguised in-the-money options, where the options had a lower exercise price than the market price of Engineered Support's common stock on the actual date of the award. Because the Company's stock options vested immediately, Gerhardt and the other option recipients could realize an immediate profit on the option grants which had not been authorized by shareholders.

4. As part of this scheme, on at least two occasions, Gerhardt directed Landmann to cancel and reissue previously issued Engineered Support options with a new backdated grant date and exercise price because the Company's stock price declined after the Company had granted those options. These efforts were intended to bring options that fell out-of-the-money back in-the-money, further thwarting the stock option plans' stated goal of tying compensation to increases in the Company's stock price.

5. As part of this scheme, Gerhardt also directed Landmann to improperly issue stock options to non-employee directors beyond what those directors were authorized to receive under Engineered Support's stock option plans. The Company never disclosed to shareholders that it had awarded this additional compensation to its non-employee directors in violation of the terms of the stock option plans.

6. In connection with the scheme, Gerhardt also reviewed and approved or signed proxy statements and periodic reports filed with the Commission from 1997 through 2003 which he knew, or was reckless in not knowing, contained materially false and misleading statements and omissions of material facts concerning Engineered Support's stock option grants. Gerhardt also certified materially misstated financial statements that understated compensation expenses required by Generally Accepted Accounting Principles ("GAAP"). As a result, Engineered Support materially overstated its total pretax operating income of \$148 million (for the fiscal years 1997 through 2002) by approximately \$26 million, or 21%.

7. Gerhardt also was involved in the preparation, review, and approval of stock option award letters and certificates which contained false grant dates. These documents were provided to Engineered Support's auditors as evidence of the actual grant dates. Gerhardt knew that these documents and the other underlying accounting and business records relating to the Company's option grants concealed the options backdating.

8. These manipulative options granting practices improperly increased the compensation granted to the employees and executives of Engineered Support by a total of \$20 million. Gerhardt personally received ill-gotten gains, including at least \$1,906,300 in unauthorized compensation, from his participation in this scheme.

JURISDICTION AND VENUE

9. This Court has jurisdiction over this action pursuant to Sections 20(b) and 22(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77t(b), 77v(a)], and Sections 21(d), 21(e) and 27 of the Securities Exchange Act of 1934 ("Exchange Act")

[15 U.S.C. §§ 78u(d)-(e), 78aa]. The defendant has, directly or indirectly, made use of the means and instrumentalities of interstate commerce, or the mails, or of the facilities of a national securities exchange in connection with the acts, practices and courses of business alleged in this complaint.

10. This is an appropriate venue under Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Section 27 of the Exchange Act [15 U.S.C. § 78aa]. The transactions, acts, practices and courses of business constituting the violations alleged herein occurred within the Eastern District of Missouri, and the defendant resides here.

THE DEFENDANT

11. Gary C. Gerhardt, age 61, is a resident of St. Charles, Missouri. Gerhardt was Engineered Support's CFO from 1993 until January 2006 and served on Engineered Support's board of directors from 1998 until January 2006. During the time periods relevant to this proceeding, Gerhardt actively participated in the issuance of Engineered Support employee stock options.

ENTITY INVOLVED

12. Engineered Support Systems, Inc. is a Missouri corporation with its principal place of business in St. Louis, Missouri. Engineered Support is a holding company for a number of wholly-owned subsidiaries that design and manufacture military support equipment and electronics, primarily for the U.S. Department of Defense. The Company and its subsidiaries employ more than 3,000 people and its main products include tank trailers, heavy cargo loading equipment, portable generators, field shelters, distribution systems for fuel, water and air, and radar and other electronics systems. Engineered Support's common stock was traded on the NASDAQ NMS, and

was registered with the Commission pursuant to Section 12(g) of the Exchange Act, until it was acquired by DRS Technologies, Inc. on January 31, 2006.

FACTS

Engineered Support's Stock Option Plans

13. Since at least 1992, Engineered Support issued stock options to employees and non-employee directors pursuant to shareholder-approved stock option plans. From 1997 through 2002, the Company had two stock option plans in effect: one for officers, employees and consultants ("Stock Option Plan"), and one for non-employee directors ("Non-employee Director Plan"). Copies of these plans were included in the Company's proxy statements filed with the Commission, and were approved by the Company's shareholders.

14. Engineered Support's Stock Option Plan set a total amount of options to be allocated among officers, employees, and consultants, with the individual awards to be determined by the Compensation Committee of the Board of Directors. All options granted under this plan vested immediately.

15. Engineered Support's Non-employee Director Plan provided for non-employee directors to receive a fixed number of options each year immediately following the annual shareholders meeting in March. Non-employee directors were not eligible to receive any additional options grants under any of Engineered Support's stock option plans. This limitation was intended to ensure compliance with Rule 16b-3 of the Exchange Act. All options granted under this plan vested immediately.

16. The Company explicitly stated in both plans that all options were to be granted with an exercise price equal to the closing price of Engineered Support's common stock on the date that the options were awarded.

17. Michael F. Shanahan, Sr. ("Shanahan"), Engineered Support's Chief Executive Officer and Chairman of the Board of Directors, was ultimately responsible for authorizing stock option grants during the relevant period. However, Gerhardt actively participated in and approved nearly all options granting decisions. He was also responsible for overseeing the completion of the stock option certificates and award letters for Engineered Support's option grants. Gerhardt personally selected the specific grant dates to be used for many of those option grants.

Engineered Support's Backdating of Stock Option Grant Dates

18. From 1997 through 2002, Gerhardt engaged in several manipulative options granting schemes and practices at Engineered Support that were not disclosed in filings with the Commission.

19. Gerhardt repeatedly instructed Landmann to backdate Engineered Support's stock option grants, using false grant dates that corresponded to low points in the Company's stock price. In most cases, the grant dates for Engineered Support's options differed from the date those options were actually awarded. The backdated option grants included those purportedly issued on December 2, 1996; February 1, March 10 and September 4, 1998; July 1 and December 9, 1999; May 4, 2000; March 29, 2001; and, July 24 and October 17, 2002.

20. The intent and object of the backdating scheme was to grant undisclosed and unauthorized compensation to Company employees and directors through the use of in-the-

money stock options. Gerhardt and others intentionally concealed the fact that these options were granted at an exercise price that was lower than the closing price of Engineered Support's common stock on the date of the award.

21. Initially, Landmann informed Gerhardt that backdating options grants was prohibited by the express terms of the shareholder-approved stock option plans. Gerhardt did not dispute this fact. However, Gerhardt ordered Landmann to backdate the stock option grant dates and issue in-the-money stock options.

22. Because Engineered Support's options vested immediately, the backdating of options grants conferred an immediate monetary benefit to the option recipients. In total, grants of backdated options increased the compensation received by Engineered Support employees and non-employee directors by approximately \$20 million. Of that amount, top executives and outside directors received approximately \$15 million. Gerhardt personally received \$1,906,300 in additional compensation as a result of backdating. Nearly half of the unauthorized and undisclosed compensation derived from the options backdating, or approximately \$8.6 million, was received by Shanahan, who was the Company's chief executive.

23. Most of the backdating activity was documented in contemporaneous writings. For example, on March 10, 1998, Gerhardt created a list of Engineered Support stock prices from January 28 through February 27, 1998. Gerhardt highlighted January 30 and the corresponding stock price and wrote, "stock effective 2/1/98." Gerhardt initialed and dated the note, "GCG 3/10/98." By using February 1, 1998, which was a Sunday, as the grant date, Gerhardt obtained a January 30 closing price and was able to avoid dating the

option grant within Engineered Support's previous reporting period, which ended January 31.

24. Approximately one month later, on April 8, 1998, Gerhardt wrote Landmann a note, which stated, "IAW previous discussions with MFS Sr. please issue/authorize the following stock options," and provided a list of recipients, the number of shares for each recipient, and the "Effective Date" of the options, which was either February 1 or March 10.

25. On another occasion, on July 12, 2000, Gerhardt provided a list of potential option recipients to Michael Shanahan, Jr. ("Shanahan Jr."), who was Shanahan's son and one of the Company's outside directors. This list contained a date, "4-May-00," and a price, "10 13/16," which was the closing price of the stock on that date. Shanahan Jr. made changes to the number of shares certain recipients were to receive and faxed the list back to Gerhardt on July 17. Engineered Support subsequently issued options for 494,500 shares of Company stock with a May 4, 2000 grant date and corresponding exercise price, which was the lowest possible exercise price during that quarter.

Repricing of Engineered Support Stock Options

26. On a few occasions, Engineered Support's stock price fell shortly after the issuance of backdated stock options. The decline in the stock price meant that the options were no longer in-the-money, rendering them temporarily valueless. On two of these occasions, Gerhardt directed Landmann to reprice all of the stock options that had fallen out-of-the-money. This was done by cancelling and reissuing the options with a new grant date and lower corresponding exercise price, which restored the lost financial benefit. In these instances, both the original options issuance and the subsequent, repriced issuance contained backdated grant dates. This double-backdating provided

option recipients with the lowest possible exercise price for the options. These repriced options contained grant dates of September 4, 1998 and July 1, 1999. Engineered Support never disclosed its repricing of stock options to shareholders or its auditors, instead reporting only the reissuance as if it were the only issuance.

27. For example, on June 1, 1999, Shanahan instructed Landmann to issue stock options for 295,000 shares of Company stock to Engineered Support executives. These stock options were issued with an April 21, 1999 grant date and were in-the-money at the time of issuance. After June 1, Engineered Support's stock price fell below the previous April 21 low point, causing the stock options to fall out-of-the-money. On July 15, 1999, Gerhardt instructed Landmann to cancel and reissue the April 21 stock options with a new grant date of July 1, 1999 and the corresponding exercise price, which was the new low point for Engineered Support's common stock so far that year.

Additional Grants to Non-employee Directors

28. Gerhardt also instructed Landmann to issue additional stock options for thousands of shares of Company stock to non-employee directors beyond the number which had been authorized by shareholders under any of Engineered Support's stock option plans. These additional options also were backdated and contained grant dates of December 2, 1996; February 1, 1998; July 1, 1999; and March 29, 2001. In total, Engineered Support issued backdated options for 132,000 shares of Company stock to non-employee directors that were not authorized by shareholders. As a result, these directors realized approximately \$6 million in unauthorized compensation from the exercise of their additional stock options.

29. Landmann attempted to prevent these options grants. In February 1996, Landmann informed Gerhardt that non-employee directors were eligible only for a fixed amount of stock options each year, pursuant to the requirements of Rule 16b-3 of the Exchange Act. Nevertheless, Gerhardt instructed Landmann to issue additional backdated stock options to non-employee directors in both January 1997 and April 1998.

30. On July 15, 1999, when Gerhardt instructed Landmann to cancel and reissue the April 21 stock options as discussed above, he also instructed Landmann to issue options for 5,000 shares of Company stock to each non-employee director with a July 1, 1999 grant date. Landmann advised Gerhardt that these grants to non-employee directors violated the terms of the Non-employee Director Plan. Gerhardt stated that he understood this, but instructed Landmann to issue the options anyway.

Misleading Filings With the Commission

31. From 1997 through 2003, Gerhardt reviewed, approved, and signed Engineered Support's Forms 10-K and 10-Q filed with the Commission, which included the Company's consolidated financial statements and notes to those statements. For the Forms 10-K and 10-Q filed in late 2002 and 2003, Gerhardt also signed certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. In those certifications, Gerhardt stated that to the best of his knowledge, the reports did not include any untrue statements of material fact or omit to state any material facts, that the financial statements fairly presented the financial condition of the Company, and that Gerhardt had disclosed all instances of fraud to the Company's Audit Committee and auditors. Gerhardt also reviewed, approved, and/or signed Engineered Support's proxy statements filed with the Commission during the same period.

32. In its consolidated financial statements filed with the Commission, Engineered Support applied the intrinsic value method of accounting under APB 25 for stock options, which required the company to recognize compensation expense for any options that were in-the-money at the time they were granted. Therefore, Engineered Support was required to recognize compensation expense equal to the difference between the market price on the date of the award and the exercise price for stock options.

33. In addition, GAAP required Engineered Support to recognize additional compensation expense if it changed the exercise price of previously issued stock options to a lower price and placed them in-the-money.

34. Gerhardt reviewed and signed financial statements filed with the Commission that did not recognize any compensation expense for Engineered Support stock options. Gerhardt did this despite his knowledge that the Company had repeatedly backdated stock options to confer in-the-money options to employees and had repriced stock option grants to preserve in-the-money benefits. By failing to disclose and recognize compensation expense associated with the backdated stock option grants and the repricing of stock options, Gerhardt caused certain of Engineered Support's consolidated financial statements contained in its Forms 10-K and 10-Q between 1997 and 2002 to be materially misstated. In the aggregate, Engineered Support's pre-tax operating income of \$148 million (from 1997 through 2002) was overstated by approximately \$26 million, or 21%.

35. In addition to misstatements associated with compensation expense, the footnotes to Engineered Support's financial statements in its Forms 10-K for the relevant years also contained the false statement that all options are granted at an option price

equal to the fair market value of the Company's common stock on the date of the award. As Engineered Support's CFO, Gerhardt was responsible for ensuring the accuracy of these footnotes, and he knew that the forgoing representations were false because of the backdating scheme.

36. Gerhardt also reviewed, approved, and/or signed Engineered Support's proxy statements filed between 1997 and 2003, which also contained material misstatements and omissions of material fact. The proxy statements represented that all options had been granted at an exercise price equal to the fair market value of the stock on the date of the award, and Gerhardt knew these statements were false.

37. Additionally, the proxy statements concealed the fact that the Company had repriced stock options in 1998 and 1999, even though Gerhardt knew about and directed each instance of repricing. Finally, the proxy statements concealed the fact that the Company had granted additional options to non-employee directors that were not approved by shareholders under any of the Company's stock option plans, and that the Company had violated the terms of the Non-employee Director Plan. Gerhardt knew that the proxy statements concealed these facts.

38. Based on his participation in the backdating scheme, Gerhardt knew, or was reckless in not knowing, that all of these misstatements and omissions caused certain of Engineered Support's Forms 10-K, Forms 10-Q, and proxy statements filed between 1997 and 2003 to be materially false and misleading.

False Statements to Auditors

39. Gerhardt also signed management representation letters in connection with the annual audits of Engineered Support. Gerhardt knew, or was reckless in not knowing,

that these letters contained false and misleading statements and omissions. For example, Gerhardt represented that the financial statements were presented in conformity with GAAP, even though he knew that Engineered Support recognized no compensation expense in connection with the Company's backdating and repricing its stock options, and that the exercise price of those backdated options was not equal to the fair market value of the Company's stock on the date of the award. Gerhardt also represented that "[t]here are no material transactions, agreements or accounts that have not been properly recorded in the accounting records underlying the consolidated financial statements," despite his knowledge that the stock option grant dates were not properly recorded. Finally, Gerhardt also falsely represented that there had been no fraud that could have a material effect on the Company's financial statements.

40. Gerhardt was also responsible for the preparation, review, and approval of the option award letters and certificates that contained false grant dates. Engineered Support provided these documents to its auditors during audits as evidence of the actual grant dates. Gerhardt failed to disclose the options backdating scheme to the auditors, when he knew the scheme was being concealed in the underlying accounting and business records relating to the option grants. Under these circumstances, Gerhardt's failures to disclose the backdating scheme constituted an omission of a material fact.

Fraudulent Sarbanes-Oxley Certifications

41. Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, Gerhardt signed certifications for Engineered Support's Forms 10-K and 10-Q for fiscal years 2002 through 2004 and the quarters contained therein, which stated that Engineered Support's periodic reports did not contain any material misstatements or omit material information,