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10 UNITED STATES DISTRICT COURT
11 NORTHERN DISTRICT OF CALIFORNIA
12 SAN JOSE DIVISION

13 C 07 44311

15 SECURITIES AND EXCHANGE COMMISSION,
16 Plaintiff,
17 vs.
18 LISA C. BERRY,
19 Defendant.

Civil Action No. _____

COMPLAINT

RMW HRL

20
21 Plaintiff Securities and Exchange Commission (the "Commission") alleges:

22 **SUMMARY OF THE ACTION**

23 1. From 1997 through 2003, the in-house corporate attorney for two different public
24 companies caused each of those companies to report false financial information to the investing
25 public by repeatedly backdating stock option grants and falsifying related paperwork. Defendant
26 Lisa C. Berry devised the improper backdating scheme while serving as General Counsel of KLA-
27 Tencor Corporation ("KLA"), and then implemented similar practices after assuming the position of
28 General Counsel for Juniper Networks, Inc. ("Juniper"). By facilitating the selection of fabricated

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1 option grant dates, Berry caused KLA, and then Juniper, to conceal hundreds of millions of dollars
2 of employee and executive compensation from investors.

3 2. Under well-settled accounting principles in effect throughout the relevant period, KLA
4 and Juniper were not required to record an expense in their financial statements for options granted to
5 employees at the then-current market price of the company's stock ("at-the-money"), but *were*
6 required to record expenses for any options granted below the current market price ("in-the-money").
7 To help KLA and Juniper attract and retain executives and employees with more valuable "in-the-
8 money" options, without disclosing to shareholders the hundreds of millions of dollars in
9 compensation expenses associated with those grants, Berry, working with others, established
10 procedures to falsify the options grant records to make it appear that the options had been granted at-
11 the-money.

12 3. On repeated occasions from 1997 until she left KLA in 1999, Berry and others caused
13 KLA to backdate stock option grants to dates when KLA's stock price closed much lower. Just prior
14 to her departure from KLA, Berry provided "how to" instructions to other employees so that KLA
15 could continue the improper backdating procedures. In 1999, when Berry moved to Juniper just
16 before it became a public company, she immediately instituted similar backdating procedures. From
17 mid-1999 through mid-2003, for dozens of different grants to groups of employees, Berry similarly
18 caused Juniper to issue backdated options.

19 4. By selecting option grant dates and prices with hindsight, Berry and others at the
20 respective companies caused KLA, and then Juniper, to issue to executives and employees valuable
21 in-the-money options without disclosing them, and further caused each company to materially
22 misrepresent their publicly-reported income (or losses), and to falsely represent in public filings with
23 the Commission that each company had no expenses related to their stock option grants.

24 5. By engaging in the acts alleged in this Complaint, Berry, among other things, violated
25 the antifraud provisions of the federal securities laws, falsified public companies' books and records,
26 and caused both KLA and Juniper to falsely report their financial results. The Commission seeks an
27 order enjoining Berry from future violations of the securities laws, requiring her to disgorge ill-gotten
28

1 gains with prejudgment interest and to pay civil monetary penalties, barring Berry from serving as an
2 officer or director of a public company, and providing other appropriate relief.

3 JURISDICTION AND VENUE

4 6. The Commission brings this action pursuant to Section 20(b) and 20(d) of the
5 Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77t(b) and 77t(d)] and Sections 21(d) and
6 21(e) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §§ 78u(d) and 78u(e)].

7 7. This Court has jurisdiction over this action pursuant to Sections 20(b) and 22(a) of the
8 Securities Act [15 U.S.C. § 77t(b) and 77v(a)] and Sections 21(d), 21(e) and 27 of the Exchange Act
9 [15 U.S.C. § 78u(d), 78u(e) and 78aa].

10 8. Berry, directly or indirectly, made use of the means or instrumentalities of interstate
11 commerce, or of the mails, or of the facilities of a national securities exchange in connection with the
12 transactions, acts, practices, and courses of business alleged herein.

13 9. This Court is a proper venue for this action pursuant to Section 22 of the Securities
14 Act [15 U.S.C. § 77v], and Section 27 of the Exchange Act [15 U.S.C. § 77aa] because acts,
15 transactions, practices, and courses of business constituting the violations alleged in this Complaint
16 occurred within this District and Berry resides in the Northern District of California.

17 INTRADISTRICT ASSIGNMENT

18 10. Intradistrict assignment to the San Jose Division is proper pursuant to Civil Local Rule
19 3-2(e) because acts or omissions giving rise to the Commission's claims occurred, among other
20 places, in Santa Clara County, California.

21 DEFENDANT

22 11. Berry, age 49, resides in Los Gatos, California. From September 1996 through June
23 1999, Berry was Vice President and General Counsel of KLA. From June 1999 to January 2004,
24 Berry was General Counsel of Juniper, and beginning in July 1999, also served as Vice President and
25 Secretary. Berry majored in accounting in college, received her juris doctorate and then obtained a
26 masters of law in taxation. Berry is licensed to practice law in California, Arizona and Florida.

RELEVANT ENTITIES

12. KLA is a Delaware corporation headquartered in San Jose, California that makes and sells systems for the semiconductor industry. At all relevant times, KLA's common stock was registered with the Commission pursuant to Section 12 of the Exchange Act and traded on the NASDAQ National Market. At all times relevant to this action, KLA used a fiscal year ending on June 30.

13. Juniper is a Delaware corporation headquartered in Sunnyvale, California that makes and sells internet-related networking products. From June 1999 through 2004, Juniper's common stock was registered under Section 12 of the Exchange Act and was traded on the NASDAQ National Market. At all times relevant to this action, Juniper used a fiscal year ending on December 31.

FACTUAL ALLEGATIONS

A. Berry and Others Backdated Options at KLA

a. KLA's Stock Option Disclosures

14. Throughout Berry's tenure as KLA's General Counsel, KLA regularly used employee stock options as a form of compensation to recruit, retain, and incentivize key employees. Each option gave the grantee the right to buy KLA common stock from the company at a set price, called the "exercise" or "strike" price, on and after a future date. The option was "in-the-money" when granted if the market price of KLA's common stock exceeded the option's exercise price. The option was "at-the-money" when granted if the market price of KLA's common stock and the exercise price were the same.

15. From approximately July 1997 through June 1999, KLA's primary stock option plan specifically prohibited the grant of in-the-money options to employees and executives. The plan required that the board of directors set the exercise price of the company's stock options, and that the price on the date of grant could not be less than fair market value – that is, the closing price of KLA's common stock on the date when granted.

16. On August 7, 1998, KLA filed with the Commission a registration statement on Form S-8 which attached the Company's primary stock option plan, and incorporated each of these key terms. Berry reviewed this statement and signed it as the company's General Counsel.

1 17. KLA also publicly represented, in audited financial statements and other filings with
2 the Commission made from 1997 through 1999, that its option grants were made at fair market value.
3 In other words, KLA purported to issue options at-the-money, not in-the-money.

4 18. KLA also stated in public filings that its audited financial statements conformed with
5 generally accepted accounting principles (known as "GAAP"). In particular, KLA disclosed that it
6 followed Accounting Principles Board's Opinion No. 25, "Accounting for Stock Issued to
7 Employees" ("APB 25") in accounting for employee stock options. Under APB 25, public companies
8 recorded an expense on their financial statements for the in-the-money portion of any options granted.
9 Consequently, granting in-the-money options to employees could have a significant impact on the
10 company's expenses and income (or loss) reported to the shareholders. APB 25 also allowed
11 companies to grant employee stock options without recording any compensation expense, so long as
12 the option exercise price was not below the closing market price for the company's stock on the date
13 of the grant.

14 19. KLA made the statements about its accounting for stock options in accordance with
15 APB 25 in the notes to its audited financial statements, including in its annual reports to shareholders,
16 filed with the Commission on Forms 10-K for its fiscal years 1998 and 1999.

17 20. KLA also filed proxy statements that were sent to shareholders announcing the annual
18 meeting of shareholders. In the proxy statements dated September 28, 1998 and October 15, 1999,
19 KLA provided information on executive compensation and executive option grants in the last fiscal
20 year from the date of filing. The discussion on executive compensation in each proxy statement
21 represented that stock options were granted at the market price on the date of the grant. In addition,
22 KLA's proxy statements filed on September 28, 1998 and October 15, 1999 stated that one of the
23 material terms of certain grants to certain executives was that the exercise price of the options was the
24 fair market value of the company's common stock as of the date of grant. These statements also were
25 incorporated by reference into KLA's Forms 10-K.

26 21. Berry reviewed, discussed, and finalized the company's annual reports filed with the
27 Commission on Forms 10-K and its proxy statements filed with the Commission on September 28,
28 1998 and October 15, 1999, as KLA's General Counsel.

1 **b. Berry Participated in the Scheme to Backdate KLA Option Grants**

2 22. In 1997, KLA's board of directors delegated to a Stock Option Committee consisting
3 of three directors the authority to grant stock options to non-officer employees. The board's
4 delegation required that at least two members of the committee approve each options grant.

5 23. From mid-1997 through mid-1999, Berry worked with KLA's Stock Option
6 Committee, which consisted of board members with such delegated authority. Berry oversaw the
7 administration of the stock option grant process.

8 24. Under procedures put in place by Berry and the Stock Option Committee, the option
9 grant approvals did not reflect the date the Stock Option Committee met to approve them. Instead,
10 grants to employees by the Stock Option Committee were deliberately delayed to allow the selection
11 of historically low stock prices with the benefit of hindsight.

12 25. Berry directed Human Resources ("HR") and stock administration department
13 employees to prepare the grant approval paperwork. Berry then directed the process for selecting the
14 exercise price by using historical information regarding low KLA stock prices of the preceding
15 weeks. One or more members of the Stock Option Committee then executed the grant paperwork
16 prepared at Berry's direction, bearing false grant dates that had been selected using hindsight.

17 26. The grant approvals were then provided to HR and stock administration personnel who
18 entered the grant information, including the backdated exercise prices, into KLA's options tracking
19 database system.

20 27. In this manner, Berry and others at KLA repeatedly backdated grants to newly hired
21 and recently promoted employees ("new hire" grants), as well as to current employees eligible for
22 options at the end of KLA's annual review process (known as "peak performance" or "focal" grants),
23 among others. These backdated grants reflected historically low prices for KLA stock for the weeks
24 prior to the date on which the price was selected.

25 28. For example, KLA awarded several grants to employees bearing a purported grant date
26 of August 31, 1998, at an exercise price equal to that day's closing stock price of \$10.63. The grants
27 included peak performance grants to officers and non-officers, as well as a new hire grant. However,
28 these grants were actually made over a span of a couple weeks during October 1998, when KLA's

1 stock was trading between \$10.75 and \$13.81, and were backdated to August 31, 1998. The August
2 31 stock price of \$10.63 was the lowest closing price for KLA's common stock for at least three
3 months prior to October 1998.

4 29. Berry personally benefited from the grant backdated to August 31, 1998, as she
5 received options to purchase 22,000 shares at the lower \$10.63 exercise price.

6 30. In another example in late 1998, Berry and others at KLA backdated a one-time
7 hundred-share grant made to thousands of KLA employees. The backdated grant used the date of
8 October 19, 1998, and the closing stock price on that date of \$27.6250 as the options' exercise price.
9 However, Berry and others actually selected the price and prepared the grant during December 1998,
10 by which time KLA's stock price had risen above \$40.

11 31. A KLA HR employee specifically questioned Berry about the propriety of backdating
12 the grant to October 19, 1998. The employee pointed out to Berry that using the date in the past when
13 the price was lower raised the question of "whether we would be able to pass the 'audit' test of not
14 setting a date in the past in order to get a better price." Berry responded, acknowledging she
15 understood, but nevertheless allowed KLA to use a backdated grant date and corresponding low price
16 without appropriately accounting for the in-the-money option grant.

17 32. On approximately ten occasions for grants backdated to July 31, 1997 through grants
18 backdated to June 15, 1999, Berry and others thus used hindsight to choose option exercise prices for
19 new hire, peak performance/focal and other grants made to KLA employees and executives.

20 33. Berry was involved in most facets of KLA's options granting process. Berry
21 participated in conference calls and communications discussing accounting rules related to stock
22 options. She also wrote a memorandum in November 1998 in which she acknowledged that repricing
23 executive stock options by using an earlier grant date with a lower price would result in KLA having
24 to take "a charge to its P&L."

25 34. In June 1999, shortly before her departure from KLA, Berry instructed employees in
26 KLA's HR department how to backdate stock option grants so that they could carry on with the
27 scheme after she had departed. Berry advised the HR personnel to: (1) create a list of newly hired
28 employees; (2) wait several weeks; (3) obtain a list of KLA's daily closing stock prices for the past

1 several weeks; (4) highlight the three or four lowest prices; and (5) forward the new hire list and the
2 highlighted stock price list to KLA's Stock Option Committee. As a consequence, KLA continued to
3 backdate certain stock option grants in this manner following Berry's departure from the company.

4 35. Berry knew, or was reckless in not knowing, that the grant documentation that she
5 helped prepare falsely represented the date on which stock options were actually granted to
6 employees. Berry further knew, or was reckless in not knowing, that the stock option grant
7 documentation that reflected the false information about the dates of the grants and exercise prices for
8 the grants, resulted in KLA's failure to properly record expenses for these in-the-money grants and
9 rendered KLA's public statements about its stock options grants false and misleading.

10 **c. KLA's Publicly Reported Financial Results**

11 36. As a public company, KLA filed with the Commission annual reports that included
12 audited financial statements, certified by the companies' outside auditors. KLA's failure to record a
13 compensation expense in connection with the backdated, in-the-money option grants resulted in
14 materially overstated net income in KLA's financial statements throughout Berry's tenure at KLA,
15 and even after she had left. Because the in-the-money options continued to affect the financial
16 statements as employees became eligible to exercise their stock options, those misstatements
17 continued through 2003.

18 37. In particular, KLA's failure to record expenses related to stock options granted in-the-
19 money resulted in a 4 percent overstatement of KLA's net income in 1998, and a 46 percent
20 overstatement of net income in 1999. KLA included those materially false representations about its
21 financial results in its annual reports to shareholders filed with the Commission on Forms 10-K for its
22 fiscal years 1998 and 1999. Berry reviewed and discussed KLA's false and misleading annual reports
23 (and drafts of those reports) filed with the Commission on Forms 10-K for the fiscal years 1998 and
24 1999, as General Counsel of KLA.

25 38. KLA also filed quarterly reports with the Commission on Forms 10-Q that included
26 financial statements for each of its first three fiscal quarters. KLA's quarterly reports filed on Forms
27 10-Q for each of the company's first three fiscal quarters of 1997 and 1998, and for the quarterly
28 period ended March 31, 1999, contained materially false and misleading financial statements due to

