

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW HAMPSHIRE

Civil Action No.

SECURITIES AND EXCHANGE COMMISSION,
Central Regional Office
1801 California Street, Suite 1500
Denver, CO 80202

Plaintiff,

v.

ANTHONY L. HURLEY
One Sawmill Way
Georgetown, MA 01833

Defendant.

COMPLAINT

Plaintiff Securities and Exchange Commission (“SEC”), for its complaint, alleges:

- 1) From March 2000 through December 2001 (the “relevant period”), Anthony L. Hurley (“Hurley”), a former assistant controller of Enterasys Networks, Inc. (“Enterasys”), which was a subsidiary of Cabletron Systems, Inc. (“Cabletron”) until August 2001, participated in a scheme to artificially inflate revenues of Enterasys and Cabletron (which are jointly referred to herein as “Enterasys”) and thereby convince investors that Enterasys was a viable independent company with consistently strong revenue growth.
- 2) During the relevant period, Hurley knowingly reviewed, and otherwise participated in transactions for which revenue was improperly recognized in

- Enterasys's financial statements and reported in periodic and other filings with the SEC and in press releases while the company's stock was publicly trading.
- 3) In carrying out the scheme to improperly inflate Enterasys's revenues, Hurley also misrepresented information to, or concealed information from, Enterasys's outside auditor concerning the true nature of some of the transactions for which the company improperly recognized revenue.
 - 4) Hurley played a role in Enterasys's financial fraud by reviewing, approving, and otherwise participating in sales transactions that lacked one or more necessary elements for revenue recognition under generally accepted accounting principles ("GAAP").
 - 5) In some of these transactions, Hurley was aware that a sale for which Enterasys intended to recognize revenue was subject to an undisclosed material contingency, such as return or cancellation rights, or that Enterasys remained responsible for reselling the underlying product. Hurley knew, or was reckless in not knowing, that it was improper to recognize revenue on these transactions that were subject to material contingencies.
 - 6) In addition, many of the problematic sales were linked to investments that Enterasys made in unaffiliated, privately-held companies in return for the investee company's agreement to use the investment proceeds to buy products from Enterasys and its former subsidiary, Aprisma Management Technologies, Inc. ("Aprisma"). Hurley knew, or was reckless in not knowing, that Enterasys was not interested in the investment aspect of these transactions, but rather used investments to improperly manage its revenues at quarter end.

- 7) Moreover, Hurley was aware that Enterasys, after failing to perform a reasonable valuation for its investment interests, frequently overpaid for investment interests in companies that could not otherwise afford Enterasys's and Aprisma's products and, in some cases, did not need the products. Accordingly, Hurley knew, or was reckless in not knowing, that Enterasys's investment transactions lacked economic substance.
- 8) In addition to lacking economic substance, some of the investment deals in which Hurley participated were not consummated until the quarter after Enterasys recognized revenue for the related sale. Hurley knew, or was reckless in not knowing, that it was improper to recognize revenue from sales that were contingent on the finalization of investments in future quarters.
- 9) During the relevant period, Hurley and other officers and employees of Enterasys caused the company to improperly recognize at least \$47 million in revenue from sales transactions flawed by one or more of the foregoing deficiencies.
- 10) The improper revenue was material information because it enabled Enterasys to meet or exceed analysts' consensus pro forma earnings per share estimates. Moreover, Hurley and others caused Enterasys to overstate by 50% to 600% its announced pro forma earnings per share for five quarters during the relevant period. Further, Hurley and others caused Enterasys to understate its operating losses by 5% to 33% for five quarters during the relevant period, and to overstate its net revenues by 8% and 25% for the final two quarters of the relevant period.
- 11) By participating in Enterasys's improper accounting practices, Hurley and others caused Enterasys to make various materially false statements in numerous SEC

filings and other documents, including: Enterasys SEC Form 10-K - for the fiscal year March 1, 2000 to March 3, 2001 (“Fiscal Year 2001”); Enterasys SEC Forms 10-Q - for the quarters March 1, 2000 to June 3, 2000 (“Q1 Fiscal Year 2001”), June 4, 2000 to September 2, 2000 (“Q2 Fiscal Year 2001”), September 3, 2000 to December 2, 2000 (“Q3 Fiscal Year 2001”), June 3, 2001 to September 1, 2001 (“Q2 Transition Year 2001”), and July 1, 2001 to September 29, 2001 (“Q3 Transition Year 2001”); and all SEC filings/statements incorporating the above documents.

- 12) Largely as a result of the materially overstated revenue reported by Cabletron in its consolidated financial statements with Enterasys, Enterasys was successfully launched as an independent public company on August 6, 2001. Prior to August 6, 2001, Cabletron’s stock was publicly traded on the New York Stock Exchange. After August 6, 2001, Enterasys’s stock was publicly traded on the New York Stock Exchange.
- 13) During the relevant period, a period in which Enterasys’s stock price was artificially inflated due to its material overstatement of revenues, Hurley realized profits from bonuses related to his improper conduct.
- 14) When Enterasys announced on February 1, 2002 that its accounting and revenue recognition practices were being investigated by the SEC, Enterasys’s stock price dropped from \$10.80 to \$4.20 per share, a loss of approximately 61%.

I. JURISDICTION AND VENUE

- 15) The SEC brings this action for injunctive relief under Sections 21(d) and (e) of the Securities Exchange Act of 1934 (“Exchange Act”) [15 U.S.C. §§ 78u (d) and (e)].

- 16) This Court has jurisdiction over this action pursuant to Sections 21(e) and 27 of the Exchange Act [15 U.S.C. §§ 78u (e) and 78aa].
- 17) In connection with the transactions, acts, practices, and courses of business described in this Complaint, Hurley, directly and indirectly, has made use of the means or instrumentalities of interstate commerce or the mails, or the means and instruments of transportation or communication in interstate commerce or the mails.
- 18) Venue is proper in this district because certain of the transactions, acts, practices, and courses of business constituting the violations of law alleged herein occurred within this district.
- 19) During the relevant period of time, Cabletron and Enterasys each had their principal place of business in Rochester, New Hampshire. Hurley worked in Rochester, New Hampshire.

II. DEFENDANT

- 20) Defendant Anthony L. Hurley, age 35, was the assistant controller for Cabletron and then Enterasys from October 1998 through November 2002. From November 1994 through June 2002, Hurley was a licensed certified public accountant in Massachusetts. Hurley had a bachelor's degree in accounting

III. HURLEY KNOWINGLY PARTICIPATED IN SALES TRANSACTIONS FOR WHICH ENTERASYS IMPROPERLY RECOGNIZED REVENUE

A. The Ariel Side Agreement

- 21) On August 31, 2001, one day before the end of the second quarter of Transition Year 2001, Ariel International Technology Co. Ltd ("Ariel"), a company based in

Hong Kong, submitted a \$4 million purchase order to Enterasys that cross-referenced an associated letter agreement. Although the letter agreement was not submitted to Enterasys's finance group, Enterasys shipped product and booked revenue for the Ariel order, one of the largest from the Asia Pacific ("APAC") region for the quarter.

- 22) Subsequently, Enterasys's outside auditor selected the Ariel transaction as part of its quarterly review and requested a copy of the letter agreement. Following repeated requests by headquarters, on September 18, 2001 the APAC office forwarded the letter agreement to Enterasys's headquarters, where it was circulated to numerous individuals, including Hurley.
- 23) After reviewing the terms of the letter agreement, Hurley and Enterasys's senior vice president of finance concluded that Enterasys should not have recognized revenue for the Ariel transaction given Ariel's extended payment terms of 150 days and Enterasys's ultimate responsibility for reselling the underlying product.
- 24) Notwithstanding that it was more than two weeks after the end of the quarter in which Enterasys had recognized revenue for the Ariel transaction, Hurley and others decided that a new letter agreement without objectionable terms should be procured from the APAC office before providing the letter agreement to Enterasys's outside auditor.
- 25) Accordingly, after backdating and removing the objectionable terms from the first page of the letter agreement, the APAC office forwarded the revised first page to Enterasys headquarters, where it was forwarded to Hurley.

- 26) After replacing the original first page of the letter agreement with the backdated and revised first page, Hurley presented the letter agreement to Enterasys's outside auditor.
- 27) As a result, Hurley knowingly participated in a scheme by which Enterasys presented a backdated document to Enterasys's outside auditor that did not reflect the true terms of the Ariel purchase as of the end of the quarter in which Enterasys improperly recognized \$3.9 million in revenue for this sale.

B. Hurley Knowingly Participated in Additional Sales Transactions for which Enterasys Improperly Recognized Revenue

- 28) In addition to the Ariel transaction, Hurley participated in Enterasys's improper recognition of revenue from additional sales transactions that were tied to material, undisclosed contingencies, including return and exchange rights or promises of future investments, were associated with continuing obligations, including making Enterasys responsible for reselling the underlying product to third parties, or otherwise lacked economic substance. During the relevant period, Hurley knew that these types of sales transactions did not qualify for revenue recognition under GAAP.
- 29) More specifically, Hurley knowingly participated in improperly recognizing approximately \$2.9 million in revenue from sales to DiscJockey.com during the first and second quarters of Fiscal Year 2001.
- 30) In addition, Hurley knowingly participated in improperly recognizing approximately \$474,000 in revenue from sales to S.A. M-COM, Inc. during the third and fourth quarters of Fiscal Year 2001.

- 31) Moreover, Hurley knowingly participated in improperly recognizing approximately \$4.18 million in revenue from sales to WorldLink Technologies, Inc., \$2.27 million in revenue from sales to KeyBridge Corp., \$940,000 in revenue from sales to GEMMS LLC, \$804,000 in revenue from sales to ParaProtect Services, Inc., and \$701,000 in revenue from sales to DigitalMojo, Inc. that was reported in the second and third quarters of Transition Year 2001.

IV. HURLEY COLLABORATED WITH OTHERS TO PROVIDE FALSE, MISLEADING, AND INCOMPLETE INFORMATION REGARDING INVESTMENT DEALS TO ENTERASYS'S OUTSIDE AUDITOR

- 32) By the first quarter of Transition Year 2001, the volume of Enterasys's investment deals increased and the quality and financial viability of the companies in which Enterasys considered investing declined. Aware that Enterasys's outside auditor had identified an investee company's independent ability to pay for product as an important prerequisite to recognizing revenue for an investment deal, Hurley and others carried out a scheme to structure investment transactions so as to conceal investment related revenue from the company's outside auditor.
- 33) In approximately March of 2001, Enterasys senior management presented the concept of a "three-corner" deal during a conference call with Enterasys's investment team, which included Hurley. During this call, senior management detailed an investment structure in which the investee company would purchase Enterasys product from a distributor or "channel partner" rather than from Enterasys directly to conceal from Enterasys's outside auditor the link between

- Enterasys's investment and the purchase, for which Enterasys would record revenue.
- 34) During this conference call and numerous subsequent weekly conference calls involving Enterasys's investment team, which included Hurley, the participants openly discussed the purpose of three-corner deals: to conceal from Enterasys's outside auditor the connection between investments and purchases, given that the poor financial condition of investee companies could lead the outside auditor to conclude that the related revenue did not comport with GAAP.
 - 35) After Enterasys structured some of its investments as three-corner deals during the first quarter of Transition Year 2001, its outside auditor became aware of two of these deals and advised Enterasys that the exchange of equity connected to the purchase of product through a third party reseller needed to be "collapsed" and viewed as a single transaction to perform the appropriate analysis for revenue recognition.
 - 36) Notwithstanding the outside auditor's admonition, Hurley and the Enterasys investment team accelerated the use of three-corner deals and continued to conceal the relevant facts from Enterasys's outside auditor during the second quarter of Transition Year 2001.
 - 37) In fact, Hurley and the investment team worked together to close more than \$20 million in investment-related sales during the final week of the second quarter of Transition Year 2001, many of which were structured as three-corner deals to conceal the precarious financial condition of the investee company from Enterasys's outside auditor.

- 38) Largely due to the improperly recognized revenue generated from these sales, Enterasys rang the opening bell of the New York Stock Exchange on August 6, 2001 and was successfully launched as a public company. Approximately three weeks later, Enterasys announced that it had again achieved its quarterly revenue target.
- 39) Thereafter, in September 2001 during the outside auditor's review of the second quarter of Transition Year 2001, Enterasys's senior management oversaw an effort to purge the three-corner deal files of all documents linking purchases to investments, the information the outside auditor had specifically requested for such revenue items in the first quarter.
- 40) Furthering the scheme to conceal important revenue information from the outside auditor, on September 8, 2001 Hurley forwarded to Enterasys's outside auditor a summary that purported to be a complete list of all investments and investment related revenue recognized by Enterasys for the quarter. In fact, this summary omitted at least \$7.6 million in improper revenue associated with the company's three-corner deals and either affirmatively represented that these investments were not associated with revenue or were associated with significantly less revenue. At the time this summary was sent to Enterasys's outside auditor, Hurley knew that it was false.
- 41) Accordingly, Hurley knowingly participated in Enterasys's improper recognition of \$7.6 million in revenue from three-corner deals during this quarter and misrepresenting material information concerning these transactions to Enterasys's outside auditor.

V. HURLEY AIDED ENTERASYS'S FILING OF FALSE FORMS 10-K AND 10-Q

- 42) As a public company, Enterasys and its directors, officers and employees were required to comply with the federal securities laws and regulations. Those laws and regulations require public companies to file annual and quarterly reports that contain financial statements that are prepared in conformity with GAAP and which contain accurate information about the financial condition of the company.
- 43) Between March 1, 2000 and December 2001, Enterasys filed one annual and six quarterly reports with the SEC.
- 44) These annual and quarterly reports were materially false and misleading because they contained financial statements that were not prepared in conformity with GAAP. In each report, Enterasys improperly recognized revenue on transactions, misrepresented the income or loss from operations, and misrepresented the net income or loss to common shareholders.
- 45) As a result of the conduct alleged above, Enterasys violated the reporting provisions of Section 13(a) of the Exchange Act and Rules 13a-1, 13a-13 and 12b-20.
- 46) With respect to the annual report filed by Enterasys for Fiscal Year 2001 and each of the quarterly reports filed by Enterasys during the relevant period, except the quarterly report for Q1 Transition Year 2001, Hurley aided and abetted Enterasys's violations of Section 13(a) of the Exchange Act and Rules 13a-1, 13a-13 and 12b-20 by knowingly providing substantial assistance of the violations by reviewing or otherwise participating in transactions for which revenue was

improperly recognized in the financial statements and reported in the filings with the SEC.

VI. HURLEY AIDED ENTERASYS'S BOOKS AND RECORDS VIOLATIONS

- 47) Enterasys was required to keep books, records, and accounts that accurately and fairly reflected the company's business transactions.
- 48) As a result of Hurley's conduct alleged above, Enterasys failed to make and keep books, records, and accounts that accurately and fairly reflected the company's business transactions and thereby violated Section 13(b)(2)(A) of the Exchange Act.
- 49) These inaccurate books, records and accounts include, but are not limited to, journal entries, postings to the general ledger, reports generated from the general ledger, financial statements, purchase orders, sales transactions files that did not contain side agreements or other documents defining the material terms of the agreement, and investment files that did not contain adequate documentation of due diligence performed to establish whether the transaction had economic substance.
- 50) Hurley was aware that his activities, which caused Enterasys to improperly recognize revenue, also caused the company to keep books, records and accounts that did not accurately record the various transactions with its customers.
- 51) As a result of his conduct, Hurley knowingly provided substantial assistance which caused Enterasys to make and keep inaccurate books, records, and accounts, and thereby aided and abetted Enterasys's violations of Section 13(b)(2)(A) of the Exchange Act.

VII. HURLEY AIDED ENTERASYS'S INTERNAL CONTROLS VIOLATIONS

- 52) Under the federal securities laws and regulations, Enterasys was required to create and maintain a system of internal controls sufficient to provide reasonable assurances that transactions were recorded in a manner that would permit the preparation of financial statements in conformity with GAAP.
- 53) Enterasys did not create and maintain a system of internal controls sufficient to assure that its financial statements were prepared in conformity with GAAP during the seven quarters starting on March 1, 2000 and continuing through September 29, 2001.
- 54) As Enterasys's assistant controller with financial reporting responsibilities, Hurley was aware by his participation in various transactions discussed above that Enterasys's internal controls were not sufficient to assure that its financial statements were being prepared in conformity with GAAP.
- 55) Hurley provided knowing and substantial assistance to Enterasys's violation of the internal control provisions of Section 13b(2)(B) of the Exchange Act by failing to implement a system to record transactions in a manner to permit the preparation of financial statements in conformity with GAAP.
- 56) Hurley aided and abetted Enterasys's violations of the internal control provisions of Section 13(b)(2)(B) of the Exchange Act.

VIII. HURLEY FALSIFIED BOOKS AND RECORDS OR CIRCUMVENTED INTERNAL CONTROLS

- 57) As a result of the conduct alleged above, between March 1, 2000 and December 29, 2001, Hurley knowingly circumvented or knowingly failed to implement a system of internal accounting controls, or knowingly falsified or caused to be

falsified a book, record or account which Enterasys was required to keep reflecting transactions and dispositions of its assets.

IX. HURLEY AIDED OFFICERS' DECEIT OF AUDITORS

- 58) Between March 1, 2000 and December 29, 2001, as a result of the conduct described above, Hurley knowingly provided substantial assistance to Enterasys officers, who made or caused to be made materially false or misleading statements to an accountant, or omitted or caused to be omitted material facts in connection with the audit, review or examination of the financial statements of Enterasys, or in the preparation of filings of any document or report required to be filed with the SEC.
- 59) Between March 1, 2000 and December 29, 2001, as a result of the conduct described above, Hurley knowingly provided substantial assistance to Enterasys officers who directly or indirectly took actions to manipulate, mislead or fraudulently influence the independent public or certified public accountant engaged in the performance of an audit or review of the financial statements of Enterasys that were required to be filed with the SEC.
- 60) As a result of the conduct described above, Hurley knowingly provided substantial assistance to Enterasys officers who created false books, records and accounts in order to mislead Enterasys's certified public accountants.
- 61) As a result of the conduct described above, Hurley knew or should have known that his actions, if successful, would result in creating financial statements that were materially misleading.

FIRST CLAIM FOR RELIEF
Fraud – Violations of Exchange Act Section 10(b) and Rule 10b-5
[15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5]

- 62) The SEC realleges paragraphs 1 through 61 above.
- 63) Hurley directly or indirectly, with scienter, in connection with the purchase or sale of securities, by the use of means or instrumentalities of interstate commerce, the mails, or any facility of a national securities exchange, employed devices, schemes, or artifices to defraud; made untrue statements of material fact or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon any person, in violation of Exchange Act Section 10(b) and Rule 10b-5.
- 64) Hurley violated and unless restrained and enjoined will in the future violate Exchange Act Section 10(b) and Rule 10b-5.
- 65) Alternatively, by reason of the conduct alleged in paragraphs 1 through 61, Enterasys violated Exchange Act Section 10(b) and Rule 10b-5 thereunder, and Hurley aided and abetted Enterasys's violations by knowingly and substantially assisting those violations. Unless restrained and enjoined, Hurley will in the future aid and abet violations of Exchange Act Section 10(b) and Rule 10b-5 thereunder.

SECOND CLAIM FOR RELIEF
Falsified Books and Records - Exchange Act Section 13(b)(5) and Rule 13b2-1
[15 U.S.C. § 78m(b)(5) and 17 C.F.R. § 240.13b2-1]

- 66) The SEC realleges paragraphs 1 through 61 above.
- 67) Hurley knowingly circumvented or knowingly failed to implement a system of internal accounting controls, knowingly falsified books, records, or accounts and directly or indirectly falsified or caused to be falsified books, records or accounts described in Section 13(b)(2) of the Exchange Act.
- 68) Hurley violated and unless restrained and enjoined will in the future violate Section 13(b) (5) of the Exchange Act and Rule 13b2-1.

THIRD CLAIM FOR RELIEF
Aiding and Abetting Deceit of Auditors - Exchange Act Rule 13b2-2
[17 C.F.R. § 240.13b2-2]

- 69) The SEC realleges paragraphs 1 through 61 above.
- 70) Hurley knowingly and substantially assisted Enterasys officers who directly or indirectly made, or caused others to make, materially false or misleading statements, or omitted, or caused others to omit, to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, to Enterasys's accountants and outside auditor in connection with an audit or examination of Enterasys's financial statements or in the preparation or filing of Enterasys's documents or reports filed with the SEC.
- 71) By reason of the foregoing, Hurley aided and abetted, and unless restrained and enjoined Hurley will in the future aid and abet, the violation of Exchange Act Rule 13b2-2.

FOURTH CLAIM FOR RELIEF
Aiding and Abetting False SEC Filings - Exchange Act Section 13(a) and
Rules 12b-20, 13a-1, and 13a-13
[15 U.S.C. § 78m(a) and 17 C.F.R. §§ 240.12b-20,
240.13a-1, and 240.13a-13]

- 72) The SEC realleges paragraphs 1 through 61 above.
- 73) Hurley aided and abetted Enterasys, in that he provided knowing and substantial assistance to Enterasys, which as an issuer of securities registered pursuant to Section 12 of the Exchange Act, filed materially misleading annual and quarterly reports with the SEC in violation of Exchange Act Section 13(a) and Rules 12b-20, 13a-1, and 13a-13 thereunder.
- 74) Unless restrained and enjoined, Hurley will in the future aid and abet violations of Exchange Act Section 13(a) and Rules 12b-20, 13a-1, and 13a-13.

FIFTH CLAIM FOR RELIEF
Aiding and Abetting False Books and Records - Exchange Act Section 13(b)(2)(A)
[15 U.S.C. § 78m(b)(2)]

- 75) The SEC realleges paragraphs 1 through 61 above.
- 76) Hurley aided and abetted Enterasys's failure to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflected the company's transactions and dispositions of its assets.
- 77) By reason of the foregoing, Enterasys violated Exchange Act Section 13(b)(2)(A), and Hurley aided and abetted Enterasys's violations. Unless restrained and enjoined, Hurley will in the future aid and abet violations of Section 13(b)(2)(A) of the Exchange Act.

SIXTH CLAIM FOR RELIEF
Aiding and Abetting Inadequate Internal Accounting Controls
Exchange Act Section 13(b)(2)(B)
[15 U.S.C. § 78m(b)(2)]

- 78) The SEC realleges paragraphs 1 through 61 above.
- 79) Hurley aided and abetted Enterasys's failure to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions were recorded as necessary to permit preparation of financial statements in conformity with GAAP or any other criteria applicable to such statements.
- 80) By reason of the foregoing, Enterasys violated Exchange Act Section 13(b)(2)(B), and Hurley aided and abetted Enterasys's violations. Unless restrained and enjoined, Hurley will in the future aid and abet violations of Section 13(b)(2)(B) of the Exchange Act.

PRAYER FOR RELIEF

The SEC respectfully requests that this Court:

- 1) Find that Hurley committed the violations alleged;
- 2) Enter an Injunction, in a form consistent with Rule 65(d) of the Federal Rules of Civil Procedure, permanently restraining and enjoining Hurley from violating, directly or indirectly, or aiding and abetting violations of the laws and rules alleged in this Complaint;
- 3) Order Hurley to disgorge all ill-gotten gains in the form of any benefits of any kind derived from the illegal conduct alleged in this Complaint, including, but not limited to, salary, bonuses, and proceeds from stock sales, plus pre-judgment interest;

- 4) Order Hurley to pay civil penalties, including post-judgment interest, pursuant to Exchange Act Section 21(d)(3) [15 U.S.C. § 78u(d)(3)], in an amount to be determined by the Court; and
- 5) Order such other relief as is necessary and appropriate.

Respectfully submitted, January 30, 2007.

/s/ Leslie J. Hughes
Leslie J. Hughes (Colo. 15043)

/s/ Jeffrey S. Lyons
Jeffrey S. Lyons (Colo. 27389)

/s/James A. Scoggins
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