IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

SECURITIES AND EXCHANGE COMMISSION,	§	
	§	
Plaintiff,	§	
	§	
v.	§	Case No.: 3:04-CV-1250
	§	
i2 TECHNOLOGIES, INC,	§	
	§	
Defendant.	§	
	§	

COMPLAINT

Plaintiff, the United States Securities and Exchange Commission (the "Commission"), files this Complaint against Defendant, i2 Technologies Inc. ("i2" or "Defendant"), and would respectfully show the Court as follows:

SUMMARY

1. For the four years ended December 31, 2001, and the first three quarters of 2002 (the "restatement period"), i2 misstated approximately $1 billion of software license revenues. As a result, i2's periodic filings with the Commission and earnings releases during the restatement period materially misrepresented i2's revenues and earnings.

2. Historically, i2 favored up-front recognition of software license revenues. But immediate recognition of revenue was inappropriate for certain of i2's software licenses because they required lengthy and intense implementation and customization efforts to meet customer needs.

3. In some cases, i2 shipped certain products and product lines that lacked functionality essential to commercial use by a broad range of users. In other cases, the company licensed certain software that required additional functionality to be usable by

particular customers. On still other occasions, i2 exaggerated certain products capabilities, or entered into side agreements with certain customers that were not properly reflected in the accounting for those transactions. In each case, significant modification and customization efforts were necessary to provide the required functionality. In addition, i2 also improperly recorded up-front software license revenue from four nonmonetary, or "barter," transactions.

4. i2 knew or was reckless in not knowing that license revenue from these transactions was ineligible for up-front recognition under generally accepted accounting principles ("GAAP"). i2's inclusion of these revenues in its filings with the Commission and earnings releases was materially misleading.

5. On July 21, 2003, following an internal investigation, i2 restated its financial statements for the restatement period. The net effect of its revenue adjustments was to decrease total revenue by $130.9 million, $477.0 million and $137.6 million in 1999, 2000 and 2001, respectively, and to increase total revenue by $385.8 million in 2002 (the cumulative impact of the revenue adjustments for the restatement period was to reduce revenue by $359.7 million, $232.4 million of which was deferred and could be recognized in the future). i2 also made certain adjustments to its expenses. The cumulative impact of all the revenue and expense adjustments for the restatement period was to increase net loss by $207.1 million.

6. Based on the conduct described herein, i2 violated Section 17(a) of the Securities Act of 1933 ("Securities Act"), [15 U.S.C. § 77q(a)], and Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Securities Exchange Act of 1934 ("Exchange Act"), [15 U.S.C. §§ 78j(b), 78m(a), 78m(b)(2)(A), 78m(b)(2)(B), and 78m(b)(5)], and Rules

10b-5, 12b-20, 13a-1, 13a-13, and 13b2-1, thereunder, [17 C.F.R. §§ 240.10b-5, 240.12b-20, 240.13a-1, 240.13a-13, and 240.13b2-1].

JURISDICTION AND VENUE

7. The Commission brings this action pursuant to the authority conferred upon it by Section 20(d) of the Securities Act, [15 U.S.C. § 77t(d)], and Sections 21(d)(3) and 27 of the Exchange Act, [15 U.S.C. §§ 78u(d)(3) and 78aa].

8. This Court has jurisdiction over this action, and venue is proper, pursuant to Sections 20(d) and 22(a) of the Securities Act, [15 U.S.C. §§ 77t(d) and 77v(a)], and Sections 21(d)(3) and 27 of the Exchange Act, [15 U.S.C. §§ 78u(d)(3) and 78aa].

9. Defendants, directly or indirectly, have made use of the means and instrumentalities of interstate commerce, or of the mails, or of the facilities of a national exchange in connection with the acts, practices, and courses of action alleged herein.

10. Venue is proper because i2 conducts business and maintains its corporate headquarters in Dallas, Texas. In addition, many of the acts giving rise to the Commission's complaint occurred in Dallas, Texas.

PARTIES

11. The Commission is an agency of the United States of America, established by Section 4(a) of the Exchange Act [15 U.S.C. § 77d(a)].

12. i2 Technologies, Inc., is a Delaware corporation headquartered in Dallas, Texas, that develops and markets enterprise supply chain management solutions, including supply chain software and service offerings. i2's common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act and was quoted on

the NASDAQ Stock Market during the periods relevant to this matter, until being de-listed on May 9, 2003. i2's common stock currently trades in the OTC Pink Sheets.

BACKGROUND FACTS

A. i2 Becomes a Billion Dollar Company

13. In 1988, i2's founders, officing in a Dallas apartment, created the company's first software program. Their work was groundbreaking in what later came to be known as the supply chain management industry. i2 went public in April 1996 and thereafter reported ever-increasing annual revenues, which grew from approximately $101 million in 1996 to more than $1.1 billion in 2000. This growth was fueled in part by numerous acquisitions, including a $68 million acquisition of Smart Technologies, Inc., in July 1999, a $390 million acquisition of SupplyBase, Inc., in May 2000, and an $8.8 billion acquisition of Aspect Development, Inc., in June 2000.

14. Large software license agreements provided the bulk of i2's revenue. i2 favored up-front recognition of the fees from these licenses. i2's compensation structure fostered this preference, because compensation of sales and pre-sales employees was largely based on the amount of revenue recognized and cash collected in the current period.

B. Accounting for Software Sales

15. AICPA Statement of Position 97-2, "Software Revenue Recognition" ("SOP 97-2"), specifies the circumstances in which a company may recognize software license revenue up-front, and when a company must recognize such revenues in accordance with contract accounting principles. Software license revenue is generally recognizable up-front under SOP 97-2 if no significant production, customization or modification of software

is required, if the remaining undelivered elements of the parties' arrangement are not essential to the functionality of the software, and if the following four basic criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery of the software has occurred, (iii) the vendor's fee is fixed or determinable, and (iv) collectibility is probable. If significant production, modification or customization is necessary, or if the additional services are essential to the functionality of delivered software, the vendor may not recognize software license revenue at the time of the sale but instead must apply contract accounting principles under Accounting Research Bulletin (ARB) No. 45, *Long-Term Construction-Type Contracts* ("ARB 45"), and AICPA Statement of Position 81-1, "*Accounting for Performance of Construction-Type and Certain Production-Type Contracts*" ("SOP 81-1").

16. In assessing whether revenue can be recognized immediately, it is irrelevant that the customer physically possesses and may use the delivered software at the outset of the arrangement; what matters is whether the customer has been delivered software with the functionality the customer agreed to purchase under the software license. If further services or modifications are necessary to permit the customer to effectively use the delivered software in the manner desired, then the vendor is prohibited from up-front revenue recognition under GAAP.

C. i2's Increased Complexity Leads to Overstated Revenues

17. i2's stock price peaked at over $110 per share in 2000, the same year it first reported $1 billion in sales. The rise in i2's stock price was powered in part by the company's ability to meet or exceed analyst expectations for revenue growth, as well as the general increase in technology stock values during this period. During the relevant period, the company experienced rapid and tremendous growth in its customer base,

number of employees and product offerings. From 1996 through 2000, i2's customer base grew to more than 1,000; its employee base grew to more than 6,300; and its product offerings grew to more than 140.

18. i2's products also grew more complex. Some of i2's software solutions were not "off-the-shelf" but rather sophisticated enterprise solutions requiring significant efforts to implement and scale to customer needs. These products frequently demanded extensive adaptation to unique customer specifications, which often required customization by i2 technicians. Accordingly, as i2 knew or was reckless in not knowing, this type of transaction was ineligible for up-front revenue recognition under SOP 97-2, and the company should instead have recognized revenue in conformity with contract accounting principles. Because of improper recognition of up-front revenues from these license transactions, i2's financial statements during the restatement period failed to conform to GAAP.

19. i2's improper revenue recognition occurred under four basic scenarios:

1. i2 Recorded Revenue from Certain Products Lacking Essential Functionality

20. On some occasions, i2 recorded license revenue from certain products and product lines that lacked basic functionality and instead required considerable code-writing, modification and customization to be usable by a broad range of customers. Consequently, recognition of license revenues from these transactions at the time of sale was inappropriate under GAAP, which i2 knew or was reckless in not knowing.

2. i2 Recorded Revenue from Certain Products that Required Additional Functionality to be Usable by Particular Customers

21. i2 licensed certain software that required development of additional customer-specific functionality. Certain i2 sales management and sales representatives knew of the functionality problems, at times describing certain i2 products as "vapor" (i.e., non-functional software) and discussing instances of "rewriting entire code." These problems should have precluded up-front recognition of all or most license revenue from these transactions.

3. i2 Exaggerated Certain Product Capabilities

22. To close certain sales, i2 sales representatives often exaggerated certain software products' capabilities. Subsequently, i2 technicians were often called upon to write code to create the promised functionality, but these efforts took much time, effort and expense. Although these substantial post-license development and modification activities obligated i2 to recognize revenue under contract accounting principles, i2 recognized all such revenues up-front.

4. i2 Executed Side Agreements and Altered Contract Language, but Failed Properly to Account for Such Changes

23. i2 also entered into undisclosed side agreements with certain customers. These side agreements outlined additional work and customization necessary for i2's software to meet customer specifications. i2 did not include the side agreement terms in the original license agreements, and did not provide the side agreements to its auditors. Under GAAP, these side agreements would have required i2 to defer license revenues from the transactions. i2, however, recognized license revenue from these transactions entirely up-front.

24. In addition, on multiple occasions, i2 requested replacing contractual terms such as "development" with "implementation," "gap analysis" with "fit analysis," and "functionality" with "features." i2 believed that these terms, if unchanged, could endanger up-front recognition of license fees under the agreements.

D. Barter Transactions

25. i2 improperly recorded revenue from four barter transactions during the restatement period. These transactions involved third-party purchases of software licenses from i2, from which i2 recognized revenue immediately, in exchange for i2's agreement to purchase from the other parties in the future a comparable amount of products or services. In some instances, i2 paid a premium over the prevailing rates for those products or services, in an effort to equalize both sides of the deal.

26. When i2 recorded revenue from these transactions, it could not determine the fair value of the items exchanged within reasonable limits. Accordingly, i2's recognition of license revenue from these transactions at the time of delivering software was improper. *See* AICPA Accounting Principles Board Opinion No. 29, *Accounting for Nonmonetary Transactions*. Moreover, i2's financial statements and Commission filings failed to disclose the true nature of these transactions, which improperly inflated i2's reported revenues by approximately $44 million. i2 knew, or was reckless in not knowing, that immediate recognition of revenues from these transactions was improper.

E. i2 Fails to Act on Revenue Recognition Warnings in 2001

27. During the summer of 2001, i2 received two documents flagging issues impacting software license revenue recognition. First, in June 2001, i2 generated a summary of revenue recognition risks, outlining such potential problems as identifying

products to meet customer needs after licenses were signed, including wrong or incorrectly positioned products in deals, substantial underestimation of implementation services necessary to meet customer needs, the provision of development and customization services without separate formal agreements and barter transactions.

28. Second, also in June 2001, i2 received the initial report of a Massachusetts Institute of Technology professor whom it had hired to analyze i2's release management and product marketing processes. This report – entitled "Product Development at i2 Technologies: Problems and Recommendations" – identified deficiencies within the organization, from shortcomings in its product and technology strategy to weaknesses in its sales practices, product release management, and quality assurance. This report specifically identified problems with certain software products that, according to the report, had become largely custom software requiring significant post-license development and implementation services to meet customer's needs.

29. i2 ignored, or was reckless in not recognizing, the revenue recognition implications of these presentations. In fact, neither the auditors nor the Audit Committee learned of the MIT professor's report until September 2002.

F. i2's Public Misrepresentations of its Financial Results

30. For the four years ended December 31, 2001, and the first three quarters of 2002, i2's reports to the Commission on Forms 10-K and 10-Q materially misrepresented i2's revenues and earnings. During this period, i2 also filed numerous registration statements on Forms S-4 and S-8, each incorporating by reference the misleading periodic reports, and offered and sold securities to the public during the restatement period.

31. i2 repeated these misstatements in quarterly and annual earnings releases to the public. In its earnings releases, i2 focused heavily on its continuing growth in revenues, increasing *pro forma* net income, and its positive relationships with its existing customers. These representations were misleading. During this period, i2's revenue was being significantly inflated by improper up-front licensing revenues; i2 was losing money, even on a *pro forma* basis in many quarters; and i2's relationship with some customers had been strained, due in part to the substantial post-license work i2 had to perform to make its software deliver what had been agreed upon.

G. i2 Restates Prior Results

32. On July 21, 2003, following an internal investigation, i2 restated its financial statements for the restatement period. The net effect of its revenue adjustments was to decrease total revenue by $130.9 million, $477 million and $137.6 million in 1999, 2000 and 2001, respectively, and to increase total revenue by $385.8 million in 2002 (the cumulative impact of the revenue adjustments for the restatement period was to reduce revenue by $359.7 million, $232.4 million of which was deferred and could be recognized in the future). i2 also made certain adjustments to expenses. The cumulative impact of all the revenue and expense adjustments for the restatement period was to increase net loss by $207.1 million. These restatements were material.

CLAIMS

FIRST CLAIM
Violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5

33. Plaintiff Commission repeats and incorporates paragraphs 1 through 32 of this Complaint by reference as if set forth *verbatim*.

34. Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a), prohibits employing a fraudulent scheme or making material misrepresentations and omissions in the offer or sale of a security. Section 10(b) of the Exchange Act, [15 U.S.C. § 78j(b)], and Rule 10b-5, [17 C.F.R. § 240.10b-5], prohibit the same conduct, if committed in connection with the purchase or sale of securities.

35. i2's misrepresentations and omissions were committed in connection with purchases and sales of i2 securities on the secondary market, and violated, therefore Section 10(b) of the Exchange Act, [15 U.S.C. § 78j(b)], and Rule 10b-5, [17 C.F.R. § 240.10b-5].

36. Because i2 offered and sold its securities in registered offerings during the restatement period, i2 also violated Section 17(a) of the Securities Act, [15 U.S.C. § 77q(a)].

37. By reason of the foregoing, i2 violated Section 17(a) of the Securities Act, [15 U.S.C. § 77q(a)], and Section 10(b) of the Exchange Act, [15 U.S.C. § 78j(b)], and Rule 10b-5, [17 C.F.R. § 240.10b-5].

SECOND CLAIM
Violations of Section 13(a) of the Exchange Act
and Rules 12b-20, 13a-1 and 13a-13

38. Plaintiff Commission repeats and incorporates paragraphs 1 through 32 of this Complaint by reference as if set forth *verbatim*.

39. Section 13(a) of the Exchange Act, [15 U.S.C. § 78m(a)], requires issuers such as i2 to file periodic reports with the Commission containing such information as the Commission prescribes by rule. Exchange Act Rule 13a-1, [17 C.F.R. § 240.13a-1], requires issuers to file annual reports and Exchange Act Rule 13a-13, [17 C.F.R. §

240.13a-13], requires issuers to file quarterly reports. Under Exchange Act Rule 12b-20, [17 C.F.R. § 240.12b-20], the reports must contain, in addition to disclosures expressly required by statute and rules, other information as is necessary to ensure that the statements made are not, under the circumstances, materially misleading.

40. By reason of the foregoing, i2 violated Section 13(a) of the Exchange Act, [15 U.S.C. § 78m(a)], and Rules 12b-20, 13a-1, 13a-13, [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-13].

THIRD CLAIM
Violations of Sections 13(b)(2)(A), 13(b)(2)(B) and 13(b)(5)of the Exchange Act and Rule 13b2-1

41. Plaintiff Commission repeats and incorporates paragraphs 1 through 32 of this Complaint by reference as if set forth *verbatim*.

42. Section 13(b)(2)(A), [15 U.S.C. § 78m(b)(2)(A)], of the Exchange Act requires all issuers to make and keep books, records, and accounts that, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

43. Section 13(b)(2)(B) of the Exchange Act, [15 U.S.C. § 78m(b)(2)(B)], requires issuers to devise and maintain an adequate system of internal accounting controls.

44. Section 13(b)(5) [15 U.S.C. § 78m(b)(5)] of the Exchange Act and Exchange Act Rule 13b2-1, [17 C.F.R. § 240.13b2-1], prohibit falsification of accounting records subject to Section 13(b)(2)(A) of the Exchange Act.

45. By reason of the foregoing, i2 violated Sections 13(b)(2)(A), 13(b)(2)(B) and 13(b)(5) of the Exchange Act, [15 U.S.C. §§ 78m(b)(2)(A), 78m(b)(2)(B), and 78m(b)(5)], and Rule 13b2-1, [17 C.F.R. § 240.13b2-1].

RELIEF REQUESTED

46. The Commission requests that the Court:

a. Enter an order directing i2 to pay disgorgement in the amount of $1, and a $10 million civil penalty, pursuant to Section 20(d) of the Securities Act, [15 U.S.C. § 77t(d)], and Section 21(d)(3) of the Exchange Act, [15 U.S.C. § 78u(d)(3)];

b. Enter an order, pursuant to Section 308 of the Sarbanes-Oxley Act of 2002, [18 U.S.C. §1 514A *et seq.*], providing that the amount of civil penalties ordered against i2 become part of a disgorgement fund for the victims of the acts alleged in this Complaint; and

c. Grant all further relief as the Court may deem just and proper.

DATED: June _____, 2004.

Respectfully submitted,

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