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UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF CALIFORNIA  
SAN JOSE DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Civil Action No.

Plaintiff,

**COMPLAINT**

vs.

IGAL KOHAVI, YAIR SHAMIR and  
GIORA YARON

Defendants.

RS

Plaintiff Securities and Exchange Commission (the "Commission") alleges as follows:

**SUMMARY**

1. During the period from at least 1997 through 2005, Mercury Interactive Corporation ("Mercury" or the "company"), through its senior management and others, engaged in a fraudulent and deceptive scheme to provide executives and other employees undisclosed, secret compensation. Through the scheme, and without disclosure, Mercury's senior management, including Chief Executive Officer Amnon Landan ("Landan") and at various times Chief Financial Officers Sharlene Abrams ("Abrams"), Douglas Smith ("Smith"), and General Counsel Susan Skaer ("Skaer"), backdated the date on which stock options were granted to executives and employees so that those

1 options appeared to have been granted at times corresponding to relative low points of the closing  
2 price of the company's stock, resulting in artificially and fraudulently low exercise prices for those  
3 options. The accounting consequences of these benefits were then concealed, as the company failed  
4 to record hundreds of millions of dollars in compensation expense on its financial statements, and  
5 provided false and misleading compensation disclosures to Mercury's public shareholders in filings  
6 with the Commission. The backdating occurred from at least 1997 to April 2002, while the  
7 overstatements of income that resulted from the backdating continued to appear in the company's  
8 financial statements through 2005.

10 2. Between 1997 and April 2002, Mercury's senior management backdated 45 stock  
11 option grants to executives and employees. Defendants Igal Kohavi ("Kohavi"), Yair Shamir  
12 ("Shamir"), and Giora Yaron ("Yaron"), as outside directors on the company's Board of Directors or  
13 as the three members of the Board's Compensation Committee, approved 21 of those grants at  
14 various times at the recommendation, or with the direct participation, of Landan, Abrams, Smith and  
15 Skaer. The other 24 stock option grants were fraudulently backdated by the company's Stock Option  
16 Committee, which consisted of Landan and at various times Abrams and Smith.

18 3. During this period, while also serving as the Board's Audit Committee, Kohavi,  
19 Shamir, and Yaron approved stock option grants that they were reckless in not knowing had false  
20 grant dates. Management selected the proposed grant dates with the benefit of hindsight, and the  
21 dates chosen were prior to the dates on which Kohavi, Shamir and Yaron actually approved the  
22 grants. Kohavi, Shamir and Yaron were aware that under Mercury's stock option plan, options were  
23 required to be priced at the closing price of the company's stock on the day that they approved the  
24 grant of options. Kohavi, Shamir and Yaron also were aware that granting options with an exercise  
25 price lower than the price on the date the options were actually approved created a compensation  
26 expense for Mercury. Kohavi, Shamir and Yaron nevertheless repeatedly signed consents and  
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1 approved Board meeting minutes despite numerous facts and circumstances that should have  
2 indicated to them that the grants they were approving were improperly backdated. Kohavi, Shamir  
3 and Yaron routinely executed documents approving grants of stock options while failing to observe,  
4 among other things, that the exercise price of stock options they were approving was less than the  
5 market price of the company's stock at the time of approval. Despite the unreported compensation  
6 expense being incurred by the backdating practice, Kohavi, Shamir and Yaron reviewed and signed  
7 the company's public filings that contained materially false and misleading disclosures regarding the  
8 company's stock option grants and fraudulent omission of hundreds of millions of dollars in  
9 compensation expense.  
10

11 4. By approving stock option grants and signing public filings under circumstances  
12 indicating certain members of Mercury's management had improperly backdated stock option grants,  
13 Kohavi, Shamir, and Yaron violated, and unless enjoined will continue to violate, Sections 10(b) and  
14 14(a) of the Exchange Act [15 U.S.C. §§ 78j(b) and 78n(a)] and Exchange Act Rules 10b-5, 13b2-1  
15 and 14a-9 [17 C.F.R. §§ 240.10b-5, 240.13b2-1 and 240.14a-9], and aided and abetted the company's  
16 violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(a),  
17 78m(b)(2)(A), 78m(b)(2)(B)] and Exchange Act Rules 12b-20, 13a-1 and 13a-13 [17 C.F.R. §§  
18 240.12b-20, 240.13a-1 and 240.13a-13].  
19  
20

#### 21 JURISDICTION AND VENUE

22 5. This Court has jurisdiction over this action pursuant to Sections 21(d), 21(e) and 27  
23 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e) and 78aa]. The defendants, directly or indirectly,  
24 have made use of the means and instrumentalities of interstate commerce, of the mails, or of the  
25 facilities of a national securities exchange in connection with the acts, practices and courses of  
26 business alleged in this Complaint.  
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1 Audit Committee from February 1996 to July 2002. Yaron has previously served on numerous  
2 boards of directors and as CEO of both a storage networks firm and a signal processing company.

3 **RELATED PARTIES AND ENTITIES**

4 11. **Mercury Interactive, LLC (formerly known as Mercury Interactive Corporation)**  
5 was acquired by the Hewlett-Packard Company ("HP") by an agreement consummated on November  
6 8, 2006, and is now a non-trading subsidiary of HP. Prior to the consummation of the merger,  
7 Mercury was a corporation headquartered in Mountain View, California, and organized under the  
8 laws of Delaware. The company made software used to test and optimize information technology  
9 systems and software applications. At the time of the conduct described in this Complaint, the  
10 company's common stock was registered with the Commission pursuant to Section 12(g) of the  
11 Exchange Act and listed on the NASDAQ under the symbol MERQ.  
12

13  
14 12. **Amnon Landan**, age 48, is an Israeli citizen who resides in Los Altos, California.  
15 Landan served as CEO of Mercury beginning in February 1997, and Chairman of the Board of  
16 Directors beginning in July 1999, until he was forced to resign those positions in November 2005.  
17 Landan is a Defendant in the matter of *SEC v. Mercury Interactive, et al.*, case number H-07-1408,  
18 filed in the Northern District of California.

19  
20 13. **Sharlene Abrams**, age 49, resides in Los Gatos, California. Abrams served as  
21 Mercury's Chief Financial Officer ("CFO"), Vice President of Finance and Administration, and  
22 Secretary between November 1993 and November 2001. Abrams is a Defendant in the matter of *SEC*  
23 *v. Mercury Interactive, et al.*, case number H-07-1408, filed in the Northern District of California.

24 14. **Douglas Smith**, age 55, resides in Ross, California. Smith served as CFO of Mercury  
25 between November 2001 and November 2005, when he was forced to resign. Prior to his tenure as  
26 CFO, he served as Mercury's Executive Vice President of Corporate Development from 2000 until  
27

1 November 2001. Smith is a Defendant in the matter of *SEC v. Mercury Interactive, et al.*, case  
2 number H-07-1408, filed in the Northern District of California.

3 15. **Susan Skaer**, age 42, resides in Menlo Park, California. Prior to 2000, Skaer was  
4 Mercury's outside counsel. Skaer served as Mercury's General Counsel and Secretary between  
5 November 2000 and November 2005, when she was forced to resign. Skaer is a Defendant in the  
6 matter of *SEC v. Mercury Interactive, et al.*, case number H-07-1408, filed in the Northern District of  
7 California.  
8

9 **FACTS**

10 16. Mercury experienced substantial growth between its initial public offering in  
11 November 1993 and its November 2006 merger with the Hewlett-Packard Company. One of the  
12 primary sources of employee compensation that the company used to fuel its expansion was stock  
13 options.  
14

15 **A. The Relevant Mercury Stock Option Plans**

16 17. The company granted options to its employees pursuant to shareholder-approved stock  
17 option plans. A plan adopted in August of 1989 ("the 1989 plan") required, as disclosed by the  
18 company, ordinary stock options to be given exercise prices that were at least 85% of the fair market  
19 value on the grant date. "Incentive" stock options ("ISOs"), which received favorable treatment  
20 under the tax laws, were required under the plan to be priced at 100% of fair market value of the  
21 company's stock on the grant date. The 1989 plan expired by its own terms in August 1999.  
22

23 18. On May 10, 1998, the company sought shareholder approval of a stock option plan to  
24 replace the 1989 plan. The pricing requirements for options under the proposed plan were identical to  
25 the requirements of the 1989 plan. The company's shareholders rejected the proposed plan.  
26

27 19. On August 14, 1998, the company's shareholders approved the 1999 Stock Option  
28 Plan ("1999 plan"), which replaced the 1989 plan. The pricing requirements for options granted

1 under the 1999 plan differed from the 1989 plan in that under the new plan, all options granted were  
2 required to be priced at 100% of the fair market value of the company's stock on the date of grant.

3 20. All Mercury stock option plans, including the 1989 plan and the 1999 plan, provide  
4 that "[t]he date of grant of an Option shall, for all purposes, be the date on which the Board makes the  
5 determination granting such Option."

6 **B. Accounting for Employee Stock Options**

7  
8 21. Generally Accepted Accounting Principles ("GAAP"), and in particular Accounting  
9 Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), did not  
10 require a company to record any compensation expense for employee stock options so long as the  
11 option exercise price was not below the stock's market price on the date of the grant. Under APB 25,  
12 employers were required to record as an expense on their financial statements the "intrinsic value" of  
13 a fixed stock option on its "measurement date." The measurement date, as defined by APB 25, is the  
14 first date on which the following information is known: (i) the number of options that an individual  
15 employee is entitled to receive, and (ii) the exercise price.

16  
17 22. An employee option granted with an exercise price lower than the quoted market price  
18 of the company's stock on the date of grant (an "in-the-money" option) has "intrinsic value," and thus  
19 the difference between the exercise price and the quoted market price of the company's stock must be  
20 recorded as compensation expense to be recognized over the vesting period of the option. Options  
21 that are at-the-money or out-of-the-money on the measurement date need not be expensed.

22  
23 **C. Management's Backdating Scheme**

24 23. The company granted options to both its executives and employees approximately  
25 once per year. In addition to this annual "refresher" grant for executives and employees, the company  
26 made numerous grants to new-hire employees throughout the year.  
27  
28

1 24. Grants to executives were made by the Compensation Committee of the company's  
2 Board of Directors, which at all times relevant to this Complaint consisted of Kohavi, Shamir and  
3 Yaron. In 1998, the Board delegated to a Stock Option Committee (which usually consisted of the  
4 company's CEO and CFO) the authority to grant options to the bulk of the company's employees.

5 25. Prior to the formation of the Stock Option Committee, grants to the bulk of the  
6 company's employees were made by the full Board, which at the time consisted of Kohavi, Shamir  
7 and Yaron, as well as the Chairman and the CEO.

8 26. Notwithstanding the distinction between executive and employee grants, the senior  
9 executives of the company — Landan, Abrams, and later Smith and Skaer — exerted substantial  
10 influence over the pricing of all of the company's options.

11 27. When stock options were to be granted to senior executives, Landan determined the  
12 amount of options that he wanted to be granted to the executives, including himself, then forwarded  
13 the recommendation to the Compensation Committee for approval.

14 28. Whenever the members of the Compensation Committee — Kohavi, Shamir, and  
15 Yaron — approved option grants recommended by senior management, they did so either by  
16 unanimous written consent or in a meeting of the Board of Directors or the Compensation  
17 Committee. Notwithstanding the date that the Compensation Committee actually gave its approval  
18 for a stock option grant, the members of the Committee later signed written consents, and on occasion  
19 signed or approved Board meeting minutes, which stated that those grants had been made "as of" a  
20 particular day, when in fact no agreement on, or approval of, a grant had occurred on that date.  
21 Likewise, the terms of those grants had not been fixed and finalized on the "as of" date.

22 29. These "as of" dates coincided with low points of the company's stock, despite the fact  
23 that the dates bore no relation to when the grant was actually approved. Rather, the dates were the  
24 result of Mercury's executives looking back and picking a purported "grant date" that coincided with  
25



1 a relative low-point of the company's stock price. The dates were chosen by the company's CEO and  
2 CFO with hindsight to provide option recipients the most valuable options possible, while creating  
3 the false appearance that the options were priced in accordance with the company's shareholder-  
4 approved stock option plan.

5 30. Kohavi, Shamir and Yaron signed written consents and approved Board meeting  
6 minutes memorializing grants of stock options that were priced at less than fair market value of the  
7 company's stock on the date of grant. As a result, Mercury incurred significant, undisclosed  
8 compensation expense that was not recorded in the company's financial reports in contravention of  
9  
10 GAAP.

11 31. Each of Kohavi, Shamir and Yaron knew that under Mercury's stock option plan,  
12 options were required to be priced at the fair market value of the company's stock on the date the  
13 option was approved.  
14

15 32. Each of Kohavi, Shamir and Yaron knew that granting an option at an exercise price  
16 less than the fair market value of the company's stock price on the date of grant created a  
17 compensation expense for the company under GAAP.

18 33. Throughout the options backdating period between 1997 and April 2002 described in  
19 this Complaint, Kohavi, Shamir and Yaron also were members of the company's Audit Committee.  
20 According to Mercury's 1999 Proxy Statement, the company's Audit Committee was "primarily  
21 responsible . . . for reviewing and evaluating the Company's accounting principles and its system of  
22 internal accounting controls."  
23

24 34. Through Kohavi, Shamir, and Yaron's approval of stock option grants and their  
25 signing of public filings under circumstances indicating that certain members of Mercury's  
26 management had improperly backdated stock option grants, Mercury generated unreported  
27  
28

1 compensation expense and filed with the Commission materially false and misleading financial  
 2 statements and disclosures regarding stock option grants.

3 35. As a result of Kohavi, Shamir and Yaron's conduct, Mercury's stock option grants  
 4 violated the pricing requirements under Mercury's shareholder approved stock option plans. Between  
 5 1997 and April 2002, either through their participation in actions taken by Mercury's Board or by  
 6 acting as the Compensation Committee of Mercury's Board, Kohavi, Shamir and Yaron approved a  
 7 total of 21 backdated grants of options to executives and employees. Each of these grants was  
 8 backdated to a date corresponding to a relative low point of the company's stock, as set forth in the  
 9 chart below:  
 10

11 Mercury Option Grants (Dated November 1996 - January 2002)

13 Claimed Grant Date	Actual Grant Date	Committee	Memorializing Document	Exercise Price	Price on Actual Grant Date	Difference in Share Price	Total Shares <sup>1</sup>
14 11/29/1996	2/4/1997	BOD	UWC	\$2.50	\$3.31	\$0.81	1,795,000
15 3/31/1997	6/9/1997	CC	UWC	\$2.44	\$3.97	\$1.53	1,260,000
16 3/31/1997	6/9/1997	BOD	UWC	\$2.44	\$3.97	\$1.53	1,683,000
17 7/23/1997	10/29/1997	BOD	UWC	\$3.81	\$5.28	\$1.47	888,000
18 10/27/1997	10/29/1997	BOD	UWC	\$4.88	\$5.28	\$0.40	448,000
19 1/9/1998	5/6/1998	BOD	UWC	\$6.31	\$10.09	\$3.78	1,920,225
20 1/9/1998	3/9/1998	CC	UWC	\$6.31	\$8.75	\$2.44	960,000
21 3/24/1998	5/6/1998	BOD	UWC	\$8.48	\$10.09	\$1.61	445,000
22 6/1/1998	7/21/1998	BOD	UWC	\$8.09	\$10.69	\$2.60	292,000
23 1/21/1999	3/9/1999	CC	UWC	\$12.03	\$17.50	\$5.47	1,180,000
24 7/15/1999	11/9/1999	CC	Minutes	\$18.25	\$48.28	\$30.03	198,000
25 1/6/2000	1/19/2000	CC	Minutes	\$40.72	\$57.47	\$16.75	1,200,000
26 5/23/2000	5/16/2000 <sup>2</sup>	CC	Minutes	\$65.20	\$84.50	\$19.30	175,000
27 5/23/2000	7/25/2000	CC	Minutes	\$65.20	\$94.69	\$29.49	450,000
28 11/29/2000	12/21/2000	BOD	UWC	\$63.06	\$80.56	\$17.50	390,000
1/8/2001	2/8/2001	CC	UWC	\$60.88	\$75.31	\$14.43	1,988,000
4/4/2001	7/6/2001	CC/BOD	UWC/Minutes	\$31.88	\$48.69	\$16.81	92,500
10/1/2001	11/6/2001	CC	UWC	\$18.74	\$28.05	\$9.31	100,000
10/1/2001	2/12/2002	CC	N/A	\$18.74	\$36.43	\$17.69	60,000

1 The share totals are adjusted to account for 2-for-1 stock splits that occurred in 1999 and 2000.

2 With respect to a small number of grants, the grant was actually approved at a board meeting prior to the represented date of grant.

Claimed Grant Date	Actual Grant Date	Committee	Memorializing Document	Exercise Price	Price on Actual Grant Date	Difference in Share Price	Total Shares <sup>1</sup>
11/2/2001 <sup>3</sup>	11/6/2001/2/12/02	CC	UWC	\$24.29	\$28.05/\$36.43	\$3.76/\$12.14	625,000
1/22/2002	2/12/2002	CC	UWC	\$29.29	\$36.43	\$7.14	1,890,000

36. The conduct of Defendants Kohavi Shamir and Yaron is illustrated by the details of the following specific grants:

**a. January 1999 Compensation Committee Grant**

37. In order to determine how many options to allocate to senior executives in Mercury's 1999 annual grant to existing employees, Landan obtained "personnel summaries" from the company's stock option administrator so that he could see what the executives had been granted in the past. The personnel summaries, which listed the total options granted to each executive, indicated that no options had been granted in 1999 to any senior executive as of the date the summaries were generated, February 5, 1999.

38. Landan did not actually generate his list of grant recommendations until early March 1999. On the evening of March 6, 1999, Abrams, Mercury's then-CFO, left a message on Landan's home answering machine reminding him that the grants needed to be finalized because Forms 4 reporting the grants to officers had not been filed and were overdue.

39. The next day, Landan forwarded his recommendations to the company's then-Chairman of the Board. The then-Chairman proceeded to contact Compensation Committee members Yaron, Kohavi and Shamir individually by telephone and seek their approval for the grants.

<sup>3</sup> Of the options with this claimed grant date, 450,000 were approved on November 6, 2001, and the remaining 175,000 on February 12, 2002.

1 40. While the Chairman was obtaining oral approval for the grants, Landan and Abrams,  
2 on March 8, looked back at the stock price of Mercury in order to determine the day on which  
3 Mercury's stock price was at a low-point. The lowest price of the year through early March was  
4 January 21, 1999.

5 41. By March 9, 1999, at least Yaron and Kohavi had indicated their intended approval of  
6 the grant in separate phone calls. Forms 4 were signed that same day and filed with the SEC on  
7 March 11, 1999, reflecting that Landan, Abrams, and other senior executives had been granted  
8 options. The reported grant date was backdated to January 21, 1999, the yearly low-point of the  
9 company's stock at the time.  
10

11 42. Approximately two weeks after March 9, 1999, Kohavi, Shamir and Yaron signed a  
12 unanimous written consent dated "as of" January 21, 1999. There was no agreement or other  
13 determination to grant the options on the represented grant date of January 21, 1999.  
14

15 43. Given that the Compensation Committee did not approve the options at the earliest  
16 until March 9, 1999, the 1,180,000 options granted to the company's senior executives were in-the-  
17 money by \$5.47 per share, or more than \$6.4 million in the aggregate, on the earliest date the options  
18 could have been approved. Mr. Landan's 600,000 options alone were in-the-money by nearly \$3.3  
19 million.  
20

21 **b. January 2002 Grant**

22 44. Smith replaced Abrams as CFO in November of 2001. He also assumed her role in the  
23 backdating scheme.

24 45. Landan, Smith and Skaer targeted December 3, 2001 – and its closing price of \$29.94  
25 per share – as the "grant date" for an employee grant being assembled in late December 2001 and  
26 early January 2002.  
27  
28

1 46. A stock option consent dated December 3, 2001, was created on January 7, 2002.

2 Also created in January 2002 was a list including the names of options recipients and the number of  
3 options each would receive with the date of December 3, 2001, and an exercise price of \$29.94, on a  
4 document entitled "Exhibit A" that typically was attached to a Mercury stock option grant unanimous  
5 written consent.

6 47. Smith and Landan executed the consent with the December 3, 2001 effective date and  
7 price of \$29.94 per share on or about January 10, 2002. However, on or about January 17, 2002,  
8 Smith discussed the pending grant with Mercury's manager of human resources and directed him to  
9 instruct the stock option administrator that she should "not send out any of the options approval  
10 emails until I get back with you tomorrow."  
11

12 48. Approximately an hour later, additional proposed changes to the tentative grant were  
13 forwarded to the stock option administrator by her supervisor, the assistant controller, who added,  
14 "Here's something to add to the grant if we keep it."  
15

16 49. However, Mercury and Stock Option Committee members Landan and Smith did not  
17 "keep" the grant. Two days later, on January 19, 2002, as the price of the company's stock began to  
18 decline to levels near the grant price from December 3<sup>rd</sup>, the manager of human resources sent  
19 Mercury's senior managers, with a copy of Smith and Landan, an e-mail explaining:  
20

21 "Our goal is to ensure the best possible out-come for the employees receiving options in this  
22 grant. For this reason we will be delaying the communication of the annual grant information  
23 for a little longer. I will let you know as soon as we have the grant date and strike price. At  
24 that time we will email your approval spreadsheets so you and your management team can let  
25 the employees know the detail of their grants."  
26

27 50. Following a sharp up-tick in the stock price on January 23, 2002, which followed an  
28 earnings announcement by Mercury on January 22, Skaer told the HR manager after 11:00 p.m. on  
January 23 that "the word is that they have 'locked' on yesterday's closing price for the employees

1 and the execs (Doug contacted the Comp Committee) – I think we should wait and see at least until  
2 the board meeting.”

3 51. Skaer wanted to “wait and see” because she “really didn’t want [the people in stock  
4 option administration] to have to redo this all a third time.”

5 52. Notwithstanding the fact that a new date had been tentatively identified, changes to the  
6 employee grant continued to be made through at least January 30, 2002, as a result of discussions  
7 between Smith and Skaer.

8 53. Landan and Smith approved the Stock Option Committee grant on or about February  
9 1, 2002, the date of the first of the e-mails indicating that a grant had been approved, dated and priced  
10 as of January 22, 2002. A number of the approval e-mails regarding this grant were sent to Mercury  
11 managers on February 5, 2002. On that date, the company’s Chief Operating Officer e-mailed Smith  
12 and asked, “Are the options approved? If so, how come I am hearing about it via notes from  
13 Europe?” The next day, Smith responded, “Yeah and have been since we revised the list in early Jan.  
14 after our go arounds. We were just waiting on price and settled on the \$29.29 price from the day of  
15 the earnings call.”

16 54. On February 1, 2002, Mercury’s stock closed at \$38.62 per share. The options granted  
17 pursuant to the backdated January 22, 2002 consent were priced at \$29.29 per share, the lowest  
18 closing price for Mercury’s stock in January 2002, and thus were “in-the-money” by \$9.33 per share,  
19 that is, by more than \$22.6 million in the aggregate.

20 55. Meanwhile, options to senior executives including Landan, Smith and Skaer, were still  
21 being assessed by senior management. On February 1, 2002, Skaer sent Smith an analysis of options  
22 granted to senior officers in the past, the amount of those options that were presently in-the-money,  
23 and the size of the “2002 recommended grant.” A personnel summary report generated for Landan on  
24 February 8, 2002, indicated that to that point he had been granted no stock options in 2002.

1 56. Options to Landan, Smith, Skaer and other senior executives were actually approved at  
2 a meeting of Mercury's Board on February 12, 2002. Prior to the meeting, Smith e-mailed Skaer and  
3 asked her to include a stock price chart in the Board materials. Smith explained: "I wanted to make  
4 sure that you recall my request to provide a history of the closing prices for MERQ from the period  
5 12/1 - 1/22/02. Igal [Kohavi] asked for this history as a part of our discussion on setting the price for  
6 exec options as at the close of the market - 1/22/02." Skaer responded, "it will be in the book."

8 57. The day after the Board meeting, Skaer sent each of the Compensation Committee  
9 members a written consent to memorialize the grant. The e-mail accompanying the document states:  
10 "Attached is a compensation committee consent for your signature. Unfortunately, you all left  
11 yesterday before I could get it. It is to approve the executive option grants that were agreed upon  
12 yesterday."

14 58. Kohavi, Shamir and Yaron each signed the unanimous written consents memorializing  
15 the grants "as of" January 22, 2002. The last of the signed consents was faxed back to the company  
16 on February 15, 2002. That same day, Skaer forwarded the list of executives granted options to the  
17 stock option administrator to generate the confirming grant documents: "Here are the ones you have  
18 been waiting for - see the list attached to the consent - \$29.29 - date is 1/22/02. Amnon is telling his  
19 folks today."

21 59. A few days later, on February 21, 2002, filings prepared at the direction of Skaer were  
22 made with the SEC representing that stock options were granted to various executives of the company  
23 on January 22, 2002. Because the executive options were falsely represented to have been granted on  
24 January 22, 2002, the options were in-the-money by a total of \$13.5 million on the day that the  
25 options were actually approved, February 12, 2002.

27 **c. Kohavi, Shamir and Yaron Approved Options Notwithstanding Numerous**  
28 **Indications of Backdating**

1           60.     During the period of the fraud, Kohavi, Shamir and Yaron repeatedly were presented  
2 with facts and circumstances that were “red flags” indicating that management was backdating option  
3 grants.

4           61.     Shamir, Yaron and Kohavi were repeatedly asked to sign written consents  
5 memorializing option grants with grant dates months before they had even been contacted by  
6 management with respect to approval of a grant. For example, management began assembling a list  
7 of grant recipients on March 7, 1999, and contacted the directors by phone that same day to approve  
8 the options. Yet the directors signed written consents just two weeks later memorializing the grant  
9 with a grant date of January 21, 1999, two months prior.

10           62.     In connection with another stock option grant, Kohavi, Shamir and Yaron were asked  
11 to sign a written consent in October 1999 memorializing a July 1999 grant. They declined to sign the  
12 consent, deciding instead to discuss the matter in a November 1999 meeting. Following the  
13 November 9, 1999 meeting at which the options were approved, Kohavi signed meeting minutes that  
14 indicated that the grant had been approved four months earlier at a meeting on July 16, 1999.

15           63.     Kohavi, Shamir and Yaron approved a grant of options to an employee at a meeting in  
16 mid-July 2001 and signed a unanimous written consent just days later memorializing the grant “as of  
17 April 4, 2001.” Management had not discussed among themselves making a recommendation to the  
18 Board for the employee’s grant until late June.

19           64.     Shortly after a November 6, 2001 Board meeting, the General Counsel sent Kohavi,  
20 Shamir and Yaron an e-mail containing a written consent to memorialize a grant of options “approved  
21 at the board meeting on November 6, 2001.” The consent, attached to the e-mail sent to Kohavi,  
22 Shamir and Yaron, was dated “as of October 1, 2001.” Kohavi, Shamir and Yaron had not been  
23 contacted about this grant on October 1, 2001, and took no actions to approve the grant on that date.  
24  
25  
26  
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1 65. In addition to signing unanimous written consents with “as of” dates that preceded the  
2 actual date of approval at times by months, Shamir, Yaron and Kohavi on a few occasions signed  
3 multiple written consents presented to them by management for the same grant with different grant  
4 dates.

5 66. For instance, Shamir, Yaron and Kohavi approved a grant of options by written  
6 consent dated December 20, 2000. Each director signed the consent and faxed it back to the  
7 company. The next month, in late January, the directors signed a second consent, memorializing the  
8 grant of the same options to the same employees, “as of January 8, 2001,” after the stock price had  
9 fallen below the December 20, 2000 price. The Defendants had not been contacted about this grant  
10 on January 8, 2001.  
11

12 67. In January 2002, Shamir, Yaron and Kohavi signed a written consent granting options  
13 to the CFO “as of November 5, 2001,” the day before the November 6, 2001 Board meeting where  
14 the options to the CFO were actually approved. Just weeks later, following a February 12, 2002  
15 meeting, the directors signed a second consent memorializing this same grant to the CFO, this time  
16 “as of November 2, 2001,” a day with a slightly lower stock price than November 5 or 6. Shamir and  
17 Yaron signed the consent on February 13, 2002, and Kohavi on February 15, 2002.  
18

19 **D. Materially False and Misleading Statements and Omissions in Mercury’s Filings with**  
20 **the Commission**

21 68. As a public company, Mercury filed with the Commission annual reports that included  
22 audited financial statements, certified by the company’s outside auditors. Mercury’s public filings  
23 affirmatively stated that the company accounted for its stock options granted to employees in  
24 accordance with GAAP.  
25

26 69. In each of its Annual Reports on Form 10-K filed on March 26, 1997, March 31, 1998,  
27 March 31, 1999, March 22, 2000 and March 29, 2001, Mercury disclosed that “[t]he Company’s  
28

1 policy is to grant options with an exercise price equal to the quoted market price of its stock on the  
2 grant date. Accordingly, no compensation cost has been recognized in the statements of operations.”

3 70. In its Annual Reports on Form 10-K filed on March 27, 2002, March 14, 2003, March  
4 5, 2004, and March 14, 2005, Mercury disclosed that it incurred compensation expense as a result of  
5 the assumption of stock options that it assumed in connection with the acquisition of certain other  
6 companies and as a result of accelerated vesting of certain options in connection with a restructuring.  
7 The company, however, reported no compensation expense for options granted to employees with  
8 exercise price below the company’s stock price on the date of grant, and each filing reported that “all  
9 options granted under the 1999 Plan must be at exercise prices not less than 100% of the fair market  
10 value.” In addition, the Annual Reports on Form 10-K filed on March 5, 2004 and March 14, 2005  
11 disclose that “[n]o stock-based compensation was recorded for stock options granted to our  
12 employees because we have granted stock options to our employees equal to the market price of the  
13 underlying stock on the date of grant.”  
14  
15

16 71. Contrary to the representations in paragraphs 69 and 70, Mercury was incurring  
17 substantial compensation expense as a result of granting in-the-money employee stock options. On  
18 July 3, 2006, Mercury restated its financial results for fiscal years 2004, 2003 and 2002, and its  
19 selected financial data for the fiscal years 2004, 2003, 2002, 2001 and 2000. The restatement  
20 reflected that the company failed to disclose compensation expense associated with backdated stock  
21 options in the aggregate amount of \$258 million. For instance, the company admitted that its reported  
22 income before taxes of \$107.1 million in 2004 was overstated by \$17.8 million; that its reported  
23 income before taxes of \$57.7 million in 2003 was overstated by \$79.5 million (resulting in a loss);  
24 that its reported income before taxes of \$82.4 million in 2002 was overstated by \$47.6 million; and  
25 that its reported income in the ten years prior to 2002 was overstated in the aggregate by \$113.4  
26 million.  
27  
28

1           72. Each of the Annual Reports on Form 10-K described in paragraphs 69 and 70  
2 materially misrepresented Mercury's stock-based compensation expense and net income and loss, and  
3 made materially false and misleading statements and omitted material information about Mercury's  
4 stock option practices. Kohavi, Shamir and Yaron each reviewed and signed each of the Annual  
5 Reports on Form 10-K referenced in paragraphs 69 and 70.  
6

7           73. Kohavi, Shamir and Yaron were reckless in not knowing that by approving  
8 backdated stock option grants Mercury filed reports (referenced in paragraphs 69 and 70 above) that  
9 contained materially false and misleading statements and omissions, and materially misrepresented  
10 financial results.

11           74. Mercury sent shareholders a proxy statement in connection with its annual  
12 shareholder meeting and periodically for special shareholder meetings during the period 1997  
13 through 2003. Kohavi, Shamir and Yaron reviewed each proxy statement between 1997 and 2003,  
14 prior to the statements being sent to shareholders and filed with the Commission. Each year, the  
15 proxy statement contained a "Report of the Compensation Committee," under the signature of  
16 Kohavi, Shamir and Yaron, which described how the Committee administered Mercury's  
17 compensation programs.

18           75. In each year, the stock option grant dates for options approved by Kohavi, Shamir  
19 and Yaron to Landan, Abrams, Smith and others were misrepresented in the proxy statements. In  
20 addition, the proxy statement and Report of the Compensation Committee failed to disclose to  
21 shareholders that Kohavi, Shamir and Yaron were administering the stock option plan in a manner  
22 that permitted the company's senior executives to receive backdated stock option grants. In each of  
23 these years, Kohavi, Shamir and Yaron sought re-election as directors of the company.

24           76. As a result of backdated options and their approval by Kohavi, Shamir and Yaron,  
25 Mercury's books and records falsely and inaccurately reflected, among other things, the dates of  
26 option grants, the company's stock-based compensation expenses, and the company's financial  
27 condition.  
28

1  
2  
3 **FIRST CLAIM FOR RELIEF**

4 *Violations of Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder by All Defendants*

5 77. The Commission realleges and incorporates by reference Paragraphs 1 through 76,  
6 above.

7 78. By engaging in the conduct described above, Kohavi, Shamir and Yaron, with  
8 scienter, directly or indirectly, in connection with the purchase or sale of securities, by the use of  
9 means or instrumentalities of interstate commerce or of the mails, or of facilities of a national  
10 securities exchange:

- 11 (a) employed devices, schemes, or artifices to defraud;  
12 (b) made untrue statements of a material fact or omitted to state a material fact  
13 necessary in order to make the statements made, in the light of the  
14 circumstances under which they were made, not misleading; and  
15 (c) engaged in acts, practices, or courses of business which operated or would  
16 operate as a fraud or deceit upon other persons, including purchasers and  
17 sellers of securities.

18 79. By reason of the foregoing, Kohavi, Shamir and Yaron violated Section 10(b) of the  
19 Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

20 **SECOND CLAIM FOR RELIEF**

21 *Aiding and Abetting Violations of*  
22 *Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1,*  
*and 13a-13 Thereunder by All Defendants*

23 80. The Commission realleges and incorporates by reference Paragraphs 1 through 79,  
24 above.

25 81. Based on the conduct alleged above, Mercury violated Section 13(a) of the Exchange  
26 Act [15 U.S.C. § 78m(a)] and Exchange Act Rules 12b-20, 13a-1, and 13a-13 [17 C.F.R. §§  
27 240.12b-20, 240.13a-1, and 240.13a-13], which obligate issuers of securities registered pursuant to  
28 Section 12 of the Exchange Act to file with the Commission annual and quarterly reports that,

1 among other things, do not contain untrue statements of material fact or omit to state material  
2 information necessary in order to make the statements made, in the light of the circumstances under  
3 which they were made, not misleading.

4 82. By engaging in the conduct described above, Kohavi, Shamir and Yaron provided  
5 substantial assistance to Mercury in connection with Mercury's filing of materially false and  
6 misleading annual reports with the Commission.

7 83. By reason of the foregoing, Kohavi, Shamir and Yaron aided and abetted, pursuant  
8 to Section 20(e) of the Exchange Act, Mercury's violations of Section 13(a) of the Exchange Act,  
9 15 U.S.C. § 78m(a), and Rules 12b-20, 13a-1, and 13a-13, 17 C.F.R. §§ 240.12b-20, 240.13a-1, and  
10 240.13a-13.

### 11 **THIRD CLAIM FOR RELIEF**

#### 12 *Violations of Exchange Act Rule 13b2-1 by All Defendants*

13 84. The Commission realleges and incorporates by reference Paragraphs 1 through 83,  
14 above.

15 85. By engaging in the conduct described above, Kohavi, Shamir and Yaron directly or  
16 indirectly falsified, or caused to be falsified, books, records, or accounts subject to Section  
17 13(b)(2)(A) of the Exchange Act [15 U.S.C. § 78m(b)(2)(A)].

18 86. By reason of the foregoing, Kohavi, Shamir and Yaron violated Exchange Act Rule  
19 13b2-1 [17 C.F.R. § 240.13b2-1].

### 20 **FOURTH CLAIM FOR RELIEF**

#### 21 *Aiding and Abetting Violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act 22 by All Defendants*

23 87. The Commission realleges and incorporates by reference Paragraphs 1 through 86,  
24 above.

25 88. Based on the conduct alleged above, Mercury violated Section 13(b)(2)(A) of the  
26 Exchange Act [15 U.S.C. § 78m(b)(2)(A)], which obligates issuers of securities registered pursuant  
27 to Section 12 of the Exchange Act [15 U.S.C. § 78l] to make and keep books, records, and  
28

1 accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions  
2 of the assets of the issuer.

3 89. Based on the conduct alleged above, Mercury violated Section 13(b)(2)(B) of the  
4 Exchange Act [15 U.S.C. § 78m(b)(2)(B)], which obligates issuers of securities registered pursuant  
5 to Section 12 of the Exchange Act [15 U.S.C. § 78l] to devise and maintain a system of internal  
6 accounting controls sufficient to provide reasonable assurances that transactions are recorded as  
7 necessary to permit preparation of financial statements in conformity with GAAP.

8 90. By engaging in the conduct described above, Kohavi, Shamir and Yaron provided  
9 substantial assistance to Mercury in connection with its failure to make and keep books, records,  
10 and accounts, which, in reasonable detail, accurately and fairly reflected the transactions and  
11 dispositions of the assets of Mercury.

12 91. By engaging in the conduct described above, Kohavi, Shamir and Yaron provided  
13 substantial assistance to Mercury in connection with its failure to devise and maintain a system of  
14 internal accounting controls sufficient to provide reasonable assurances that transactions are  
15 recorded as necessary to permit preparation of financial statements in conformity with GAAP.

16 92. By reason of the foregoing, Kohavi, Shamir and Yaron aided and abetted, pursuant  
17 to Section 20(e) of the Exchange Act, Mercury's violations of Sections 13(b)(2)(A) and 13(b)(2)(B)  
18 of the Exchange Act [15 U.S.C. §§ 78m(b)(2)(A), 78m(b)(2)(b)].

19 **FIFTH CLAIM FOR RELIEF**

20 *Violations of Section 14(a) of the Exchange Act and Rule 14a-9 Thereunder*  
21 *by all Defendants*

22 93. The Commission realleges and incorporates by reference Paragraphs 1 through 92,  
23 above.

24 94. Defendants Kohavi, Shamir and Yaron, directly or indirectly, by use of the means or  
25 instruments of interstate commerce or of the mails, or of the facility of a national securities  
26 exchange, recklessly or negligently solicited proxies by means of a proxy statement, form of proxy,  
27 notice of meeting or other communication, written or oral, containing statements which, at the time  
28 and in light of the circumstances under which they were made, were false and misleading with  
respect to material facts, or which omitted to state material facts which were necessary in order to

1 make the statements made not false or misleading or which were necessary to correct statements in  
2 earlier false or misleading communications with respect to the solicitation of proxies for the same  
3 meeting or subject matter.

4 95. By engaging in the conduct described above, Defendants Kohavi, Shamir and Yaron  
5 violated Section 14(a) of the Exchange Act [15 U.S.C. § 78n(a)] and Exchange Act Rule 14a-9 [17  
6 C.F.R. § 240.14a-9].

7 **PRAYER FOR RELIEF**

8 WHEREFORE, the Commission respectfully requests that this Court:

9 I.

10 Issue an order permanently restraining and enjoining all Defendants from violating Sections  
11 10(b) and 14(a) of the Exchange Act [15 U.S.C. §§ 78j(b) and 78n(a)], and Exchange Act Rules 10b-  
12 5, 13b2-1 and 14a-9 [17 C.F.R. §§ 240.10b-5, 240.13b2-1 and 240.14a-9], and from aiding and  
13 abetting violations Sections 13(a), 13(b)(2)(A), 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§  
14 78m(a), 78m(b)(2)(A), 78m(b)(2)(B)] and Exchange Act Rules 12b-20, 13a-1 and 13a-13 [17 C.F.R.  
15 §§ 240.12b-20, 240.13a-1 and 240.13a-13].

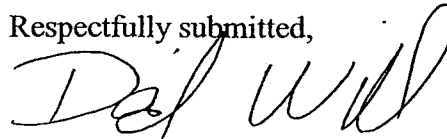
16 II.

17 Issue an order directing each Defendant to pay a civil monetary penalty under Section  
18 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)].

19 III.

20 Grant such other and further relief as this Court may determine to be just and necessary.

21 Respectfully submitted,



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Dated: \_\_\_\_\_, 2008