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

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14 SECURITIES AND EXCHANGE COMMISSION,
15 Plaintiff,
16 vs.
17 INTEGRATED SILICON SOLUTION, INC. and
18 GARY L. FISCHER,
19 Defendants.

Case No.

COMPLAINT

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

22 **SUMMARY OF THE ACTION**

23 1. This matter involves improper stock option backdating at Integrated Silicon Solution,
24 Inc. ("ISSI" or the "Company"), a Silicon Valley semiconductor company, resulting in the
25 Company's issuance of false financial statements concealing millions of dollars in compensation
26 expenses. Between 1997 and 2005, ISSI issued over sixty option grants to officers and employees
27 using incorrect grant dates, resulting in a failure to report nearly \$32 million in expenses to investors.
28 Defendant Gary L. Fischer, ISSI's then-Chief Financial Officer, President and member of the Board

1 of Directors, picked the backdated option grant dates and directed others to prepare grant documents
2 using the incorrect dates. Fischer personally benefited from the backdating, receiving over \$350,000
3 in compensation that was not disclosed in proxy statements as a result of the backdated options.

4 2. Under well-settled accounting principles in effect throughout the relevant period, ISSI
5 was not required to record an expense in its financial statements for options granted at the market
6 price (“at-the-money”), but *was* required to record expenses for any options granted below the current
7 market price (“in-the-money”). ISSI engaged in a recurring practice of granting in-the-money
8 options to its officers and employees. Fischer backdated the grants to dates on which the stock was
9 trading at significantly lower prices. Fischer directed others to create company records that gave the
10 appearance that the options had been granted at the market price on an earlier date – including the
11 creation of numerous minutes for ISSI’s Compensation Committee meetings and numerous
12 resolutions for the Stock Option Committee. In reality, the Compensation Committee rarely met on
13 the purported dates of the minutes, and the Stock Option Committee rarely took any action on the
14 dates of the purported resolutions.

15 3. As a result, Fischer’s actions caused ISSI to materially understate its expenses,
16 overstate its income, and misrepresent in numerous SEC filings that ISSI had incurred no expense for
17 option grants.

18 4. By engaging in the acts alleged in this Complaint, defendants ISSI and Fischer, among
19 other things, violated the antifraud provisions of the federal securities laws, made or caused to be
20 made materially false or misleading statements to ISSI’s auditors, falsified books and records, and
21 caused ISSI to falsely report its financial results. The Commission seeks an order enjoining
22 defendants from future violations of the securities laws, requiring defendant Fischer to disgorge ill-
23 gotten gains with prejudgment interest and to pay civil monetary penalties, barring Fischer from
24 serving as an officer or director of a public company, and providing other appropriate relief.

25 JURISDICTION AND VENUE

26 5. The Commission brings this action pursuant to Sections 20(b) and 20(d) of the
27 Securities Act of 1933 (“Securities Act”) [15 U.S.C. §§ 77t(b) and 77t(d)] and Sections 21(d) and
28 21(e) of the Securities Exchange Act of 1934 (“Exchange Act”) [15 U.S.C. §§ 78u(d) and 78u(e)].

FACTUAL ALLEGATIONS

A. ISSI's Options Granting Program

11. From the mid 1990s to the mid 2000s, ISSI, like many other companies, made liberal use of employee stock options as a form of compensation to recruit, retain, and incentivize employees, officers and directors. Each option gave the grantee the right to buy one share of ISSI common stock from the Company at a set price, called the "exercise" or "strike" price, on a future date after the option vested. The option was "at-the-money" when granted if the trading price of ISSI's common stock and the exercise price were the same. The option was "in-the-money" when granted if the trading price of ISSI's common stock exceeded the option's exercise price. Throughout most of the relevant time period, ISSI's 1998 Stock Plan prohibited granting in-the-money stock options.

12. ISSI publicly represented, in audited financial statements and other filings with the Commission throughout the relevant period, that its option grants were made at fair market value. In other words, ISSI purported to issue options at-the-money, not in-the-money.

13. ISSI's public filings affirmatively stated that the Company accounted for its employee stock option plans in accordance with provisions of the Accounting Principles Board's Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Under APB 25 and the accounting rules in effect in 1997 through 2005, public companies were required to record an expense on their financial statements for the in-the-money portion of an options grant. According to APB 25, that difference between the exercise price (if lower) and the quoted market price on the date of actual grant was required to be recorded as compensation expense, recognized over the vesting period of the option. Consequently, granting in-the-money options to employees could have a significant impact on the expenses and income (or loss) reported to the shareholders of a public company.

14. ISSI made the statements about its accounting for stock options in accordance with APB 25 in the notes to its audited financial statements, including in its annual reports to shareholders, filed with the Commission on Form 10-K, for its fiscal years 1997 through 2005. Also, ISSI's annual report filed on Form 10-K for the fiscal years 1997-2002, represented that, following this rule, the Company fixed prices for its options at 100% of fair market value on the date of the grant. In

1 addition, ISSI's proxy statements (which were sent to its shareholders) for the fiscal years 1997 and
2 fiscal years from 1999 to 2005 state that the exercise price of the options grants to executives
3 reflected their fair market value as determined by the Company's board of directors on the date of the
4 grant.

5 **B. Fischer's Role in ISSI's Stock Option Grant Process**

6 15. ISSI's primary stock plan allowed ISSI's Board to delegate the grant of options to a
7 board committee, but did not authorize non-board members to either grant options or select an
8 effective grant date. Since at least 1996, ISSI's Board delegated stock option approval to two Board
9 committees: the Stock Option Committee and the Compensation Committee. The Stock Option
10 Committee approved grants for non-officer employees, which were documented in Stock Option
11 Committee resolutions. The Compensation Committee approved grants to officers. These grants
12 were documented in Compensation Committee minutes that purported to record the events of
13 Compensation Committee meetings.

14 16. Contrary to the stock option plan and the Board's delegation of grant powers to the
15 two committees, Fischer, not the committee members, selected the dates of grants for both officers
16 and employees. The grant dates he selected were then incorporated into the Stock Option Committee
17 resolutions and Compensation Committee minutes.

18 17. The dates on the resolutions and minutes generally did not reflect the date a granting
19 action took place or a committee meeting occurred. The committee members rarely, if ever, met on
20 the date listed on the minutes and resolutions. Instead, the committee members almost always signed
21 the resolutions and minutes at the Company's regularly scheduled board meetings, which were often
22 held after the effective grant date stated on the grant documents.

23 **C. The Use of Hindsight to Pick Advantageous Exercise Prices**

24 18. Between 1997 and 2005, Fischer used his ability to pick grant dates to select dates on
25 which ISSI's stock traded at or near monthly or quarterly lows, and at prices below the closing price
26 on the date when Fischer actually selected the grant date. This resulted in the issuance of in-the-
27 money options; by backdating the grant documents, ISSI created the false appearance that the grants
28 were at-the-money, thus avoiding reporting a compensation charge.

1 19. According to ISSI's Form 10-K filed on May 30, 2007, the Company determined that
2 63 grants made between 1997 and 2005 were either clearly backdated or appeared to be misdated
3 with original grant prices that were lower than the grant price determined to be correct by the
4 Company. The Company determined that it should have recognized over \$29 million in
5 compensation expenses during this period.

6 20. In certain instances, Fischer selected a grant date that was weeks or even months
7 earlier than when he actually selected the date. For example, on July 6, 2000, Fischer sent an email
8 to an ISSI senior officer suggesting that ISSI grant options backdated to April 2000 and record no
9 expense charge for the grants. At the time Fischer sent his email, ISSI stock was trading at about
10 \$32.00. Fischer, however, suggested in his email that ISSI pick a date in April 2000 when ISSI's
11 stock was trading at much lower prices:

12 Use a grant date of [Monday] April 17 and the closing price of that date of
13 \$23.125. It is not the lowest of the quarter but follows the lowest date
14 which was Friday April 14. Implies we tried to take advantage of the drop
15 by quickly locking in on the following Monday....Obviously the
16 advantage is no P&L impact plus the person gets the upside of the
17 remaining vesting....To accomplish this we would need the stock
18 committee to approve by approximately July 12 so we can document it all
19 for [ISSI's outside auditors].

20 21. Although Fischer suggested using the Monday price, the Company actually chose the
21 previous Friday, April 14, as the grant date. ISSI documented the grant for both officers and
22 employees through Compensation Committee minutes and Stock Option Committee resolutions dated
23 April 14, 2000 and reflecting an option price of \$18.56 a share – the lowest stock price of that
24 quarter, which gave the grant recipients (including Fischer) in-the-money stock options. Those
25 options were underpriced by \$16.82 per share.

26 22. ISSI did not record a compensation expense related to the "April 14, 2000" grant as
27 required by the relevant accounting rules. For the 51,000 executive options and over 395,000
28 employee options in this grant, ISSI should have recorded a compensation expense of approximately

1 \$6 million. Had ISSI appropriately recorded a compensation expense for this option grant, it would
2 have changed its reported 2001 net profit of \$1.1 million to a net loss of over \$1.9 million.

3 23. Fischer received 12,000 in-the-money options in the April 14, 2000 backdated grant.
4 Those shares were underpriced by \$201,810 at the time of the grant in July 2000.

5 24. ISSI also backdated options given to ISSI's officers and employees pursuant to
6 voluntary or mandatory "salary reduction programs" in which employees received reduced salaries in
7 exchange for stock option grants. For example, in April 2002, Fischer sent an email to Company
8 employees announcing a salary reduction program in which employees could volunteer to receive
9 stock options in exchange for a reduced salary. Although the employees participating in the program
10 were identified by the end of April 2002, when the stock was trading at around \$14, the grant date
11 was not selected by ISSI until months later, after the Company's stock price had declined
12 significantly. In August 2002, Fischer used hindsight to propose a grant date of August 6, 2002,
13 when the company's stock traded at \$4.56. ISSI did not record a compensation expense related to
14 this grant.

15 25. Fischer personally benefited from the low stock price on the "August 6, 2002" grant.
16 He received 9,231 in-the-money options in that grant, which he exercised in January 2004. Fischer's
17 options from this grant were underpriced by \$3,600.

18 **D. ISSI Made False Filings with the Commission**

19 26. The options backdating practice caused ISSI to materially misstate its financial results
20 during the periods 2000 to 2005. Fischer knew (or was reckless in not knowing) the applicable
21 accounting rules. He was informed no later than 1997 by ISSI's controller that the Company must
22 expense the in-the-money value of stock options, an understanding he confirmed at the time in an
23 email concerning a potential in-the-money option grant.

24 27. As a public company, ISSI filed with the Commission annual reports that included
25 audited financial statements, certified by the Company's outside auditors. ISSI's failure to record a
26 compensation expense in connection with the backdated, in-the-money option grants resulted in
27 materially overstated net income or understated net losses in its Forms 10-K.
28

1 28. On May 30, 2007, ISSI filed a Form 10 K that restated financial results and disclosed
2 that the Company should have recorded compensation expense of over \$29 million between 1997 and
3 2005 for 63 grants affecting 13.9 million stock options. By failing to record compensation charges
4 for the “in-the-money” portions of the backdated grants, ISSI materially overstated its actual net
5 income (as restated), or understated its actual net loss (as restated), as follows: a 25% understatement
6 of net loss in 1999; a 38% overstatement of net income in 2000; a change from \$1.1 million net
7 income to a \$5.3 million net loss in 2001; a 7% understatement in net loss in 2002; a 13%
8 understatement of net loss in 2003; a 528% overstatement of net income in 2004, and a 5%
9 understatement of net loss in 2005.

10 29. For the fiscal years 1997 through 2005, Fischer reviewed and signed (as the CFO or as
11 a Director) each of the Forms 10-K. For the fiscal years 2002 through 2005, Fischer also signed
12 certifications in the Forms 10-K that certified that those Forms did not contain any untrue statement
13 or omission of a material fact and the financial statements in the reports fairly presented in all
14 material respects the financial condition and results of ISSI.

15 30. ISSI also recorded no compensation expense in connection with the backdated, in-the-
16 money grants to employees and officers in its quarterly reports filed on Forms 10-Q for each of the
17 first three quarters in each fiscal year from 1997 through 2005. Fischer signed all of ISSI’s Forms
18 10-Q for each of the first three quarters in fiscal years 1997 through 2000, the first two quarters of
19 fiscal year 2001, and the first three quarters for fiscal years 2003 through 2005.

20 31. ISSI filed eleven Forms 8-K, each of which announced the Company’s quarterly
21 financial results, that contained materially false and/or misleading financial information because of
22 ISSI’s failure to record compensation expenses associated with undisclosed grants of in-the-money
23 stock options (filed on April 24, 2003, July 24, 2003, October 30, 2003, January 12, 2004, April 22,
24 2004, July 22, 2004, October 28, 2004, January 25, 2005, April 25, 2005, July 26, 2005, and
25 November 3, 2005). Fischer signed each of these false and misleading Forms 8-K.

26 32. ISSI’s proxy statements (which were sent to its shareholders) filed during the fiscal
27 years 1997 and 1999 through 2005, also contained misrepresentations. Among other things, the
28 discussion on executive compensation falsely states that the exercise price of the options grants

1 reflected their fair market value as determined by the Company's board of directors on the date of the
2 grant. Fischer reviewed these statements prior to filing, and signed the notice of the shareholder
3 meeting accompanying the proxy for all of these years except 2002.

4 33. Between 1998 and 2002, ISSI sold securities pursuant to six Forms S-8, which
5 incorporated by reference the Company's previously filed Forms 10-K and 10-Q that contained the
6 false statements described above (filed on January 15, 1998, April 22, 1998, April 26, 1999, April 4,
7 2000, March 9, 2001, and March 15, 2002). Fischer signed each of these Forms S-8.

8 34. After the various grants had been issued, ISSI's auditors received copies of the
9 backdated minutes and resolutions. Fischer was aware that ISSI routinely provided the minutes and
10 resolutions to the auditors in connection with its audit work. Beginning in October 2003 and
11 continuing through December 2005, management representation letters to the auditors signed by
12 Fischer listed the purported dates of Stock Committee and Compensation Committee meetings.
13 Those dates were taken from the minutes and resolutions and were false as the committees seldom
14 met or took any action on the represented dates.

15 35. Fischer both signed and caused to be filed with the Commission false Forms 5,
16 purporting to represent his annual statements of changes in beneficial ownership of ISSI securities,
17 that incorrectly disclosed the grant dates for his options (filed on November 10, 1997, November 13,
18 2000, November 8, 2001, and November 12, 2002).

19 **E. Fischer Received Ill-Gotten Gains from the Backdated Grants**

20 36. Fischer received undisclosed backdated options that were in-the-money, and exercised
21 certain of those options.

22 **FIRST CLAIM FOR RELIEF**

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

25 37. The Commission realleges and incorporates by this reference Paragraphs 1 through 36,
26 above.

27 38. By engaging in the conduct described above, ISSI and Fischer, directly or indirectly,
28 in connection with the purchase or sale of securities, by the use of means or instrumentalities of
interstate commerce, or the mails, with scienter:

