

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

SECURITIES AND EXCHANGE COMMISSION
100 F Street, N.E.
Washington, D.C. 20549

Plaintiff,

v.

CAROLE ARGO,
209 East Highfield Road
Baltimore, MD 21218

Defendant.

Case: 1:07-cv-01397
Assigned To : Robertson, James
Assign. Date : 8/1/2007
Description: General Civil

COMPLAINT

Plaintiff, Securities and Exchange Commission (“Commission”), alleges for its
Complaint, as follows:

SUMMARY OF ALLEGATIONS

1. From at least the fourth quarter 2000 through the fourth quarter of 2005, defendant Carole D. Argo (“Argo”) formerly the president, chief operating officer (“COO”) and chief financial officer (“CFO”) of SafeNet, Inc. (“SafeNet” or the “Company”), participated in a fraudulent scheme to backdate option grants to take advantage of low points in the Company’s stock price, without causing SafeNet to record a compensation expense for those option grants, as required by Generally Accepted Accounting Principles (“GAAP”). As a direct result of this backdating scheme Argo caused SafeNet to report materially misstated financial results for at least the period from the fourth quarter of 2000 through the second quarter of 2006.

2. In furtherance of the scheme, Argo routinely looked back and selected historical dates when SafeNet's stock price had closed at or near the low for a given period to use as grant dates for SafeNet option grants. By selecting these highly favorable dates and causing options to be granted on dates when she knew they would be "in-the-money"-- that is, the exercise price of the options was lower than the market price of the stock on the date the options were granted -- Argo created an opportunity for herself and others at SafeNet to reap substantial profits. Argo then backdated documents to conceal from SafeNet's investors and outside auditors that SafeNet was issuing in-the-money option grants. Argo as well as other employees, officers and directors reaped substantial profits and other financial benefits from this scheme.

3. In connection with this scheme, from at least the fourth quarter of 2000 through the second quarter of 2006, Argo prepared and/or reviewed proxy statements, periodic reports, and Securities Act registration statements that she knew, or was reckless in not knowing, contained materially false and misleading statements and omissions concerning SafeNet's financial condition and options granting practices. These statements created the false impression that SafeNet did not grant in-the-money options to its employees and was properly accounting for its options grants. Also, because SafeNet was not properly accounting for the in-the-money options it granted, from the fourth quarter of 2000 through the second quarter of 2006, SafeNet's proxy statements, periodic reports, and Securities Act registration statements misled investors because they materially understated the Company's compensation expenses and materially misstated its net income or loss, and earnings per share.

4. By engaging in the conduct described above, defendant Argo, among other things, violated the antifraud provisions of the federal securities laws, falsified SafeNet's books and records, and caused SafeNet to issue false and misleading financial reports. Argo also aided and

abetted SafeNet's reporting and proxy violations. Specifically, defendant Argo violated Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77q(a)], Sections 10(b), 13(b)(5), 14(a) and 16(a) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §§ 78j(b), 78m(b)(5), 78n(a) and 78p(a)] and Exchange Act Rules 10b-5, 13a-14, 13b2-1, 13b2-2, 14a-9 and 16a-3 [17 C.F.R. §§ 240.10b-5, 240.13a-14, 240.13b2-1, 240.13b2-2, 240.14a-9 and 240.16a-3], and aided and abetted SafeNet's violations of Exchange Act Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B) and 14(a) [15 U.S.C. §§ 78j(b), 78m(a), 78m(b)(2)(A) and 78m(b)(2)(B)] and Exchange Act Rules 10b-5, 12b-20, 13a-1, 13a-13, and 14a-9 thereunder [17 C.F.R. §§ 240.10b-5, 240.12b-20, 240.13a-1, 240.13a-13 and 240.14a-9]. Unless enjoined, defendant Argo will likely commit such violations in the future. Argo should be enjoined from violating the aforesaid provisions and rules, ordered to disgorge any ill-gotten gains or benefits derived as a result of her violations, as well as prejudgment interest thereon, and ordered to pay appropriate civil money penalties. In addition, defendant Argo should be prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Exchange Act Section 12 [15 U.S.C. § 78l] or that is required to file reports pursuant to Exchange Act Section 15(d) [15 U.S.C. § 78o(d)].

JURISDICTION AND VENUE

5. The Court has jurisdiction over this action pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Sections 21(d), 21(e) and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e) and 78aa]. The defendant, directly or indirectly, used the means and instrumentalities of interstate commerce, or of the mails, or the facilities of a national securities exchange in connection with the acts, transactions, practices and courses of business alleged herein.

6. Venue is proper in the District of Columbia pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Sections 21(d), 21(e) and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e) and 78aa.

THE DEFENDANT

7. Defendant Carole Argo, age 45, is a resident of Baltimore, Maryland. Argo was SafeNet's president and chief operating officer ("COO") from June 2004 until October 2006, when she resigned as an officer of the Company. From April 2006 until her resignation in October 2006, Argo also acted as SafeNet's interim CFO. From June 1999 through June 2004, she served as SafeNet's senior vice president and chief financial officer ("CFO"). Prior to joining SafeNet, Argo served as the CFO of a public company for approximately one year and, prior to that, served as the vice president of finance and operations and controller of a privately held company for eight years. Argo is a certified public accountant ("CPA") who has seven years of public accounting experience, including working as an audit manager at a Big Four accounting firm.

SAFENET, INC.

8. SafeNet, Inc., which previously did business as Information Resource Engineering, Inc., is a Delaware corporation, with its headquarters in Belcamp, Maryland. SafeNet produces information security software products. During the relevant period, the Company's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act and listed on the NASDAQ National Market under the symbol "SFNT." In 2006, the NASDAQ National Market became an "exchange", and as a result, the Company's common stock was registered under Section 12(b), and traded on the NASDAQ National Market until April 12, 2007, when SafeNet was taken private as part of a private equity transaction. For the

year ended 2005, SafeNet reported revenues of \$263 million and net income of \$3 million.

SafeNet reported annual revenue of \$25.3 million, \$16.5 million, \$32.2 million, \$66.2 million, and \$201 million, and annual net income or loss of \$7.2 million, (\$109,000), (\$780,000), (\$6.1 million), and \$2.18 million, for fiscal years 2000 through 2004, respectively.

FACTS

A. Accounting For Options Under Generally Accepted Accounting Principles

9. Generally Accepted Accounting Principles (“GAAP”) are standards, rules and conventions that are established by the Financial Accounting Standards Board and other related bodies. Under Commission regulations, financial statements that are filed with the Commission must be prepared in conformity with GAAP.

10. SafeNet was required to comply with the GAAP standards governing accounting for stock options. The relevant accounting standard pertaining to options accounting was Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (“APB 25”), which was applicable to the company throughout the period during which the illegal conduct alleged herein occurred. APB 25 required companies to record an expense for the “intrinsic” value of an employee stock option on its “measurement date.” A stock option has intrinsic value if the exercise price of the option is lower than the market price of the underlying stock on the measurement date. The measurement date is the date upon which the company, acting through a person or entity with the requisite legal authority, has determined the exercise price of the option, the number of options, and the name of the option recipient. Under APB 25, a company that grants an employee in-the-money options is required to calculate compensation expense as the difference between the exercise price and the market price of the stock on the

measurement date and recognize that expense in the income statement over the vesting period of the option grant.

11. Although SafeNet routinely granted its employees in-the-money options, Argo knowingly or recklessly failed to cause SafeNet to record the attendant compensation expenses as required by APB 25.

12. From at least the fourth quarter of 2000 through the second quarter of 2006, SafeNet falsely represented, in reports filed with the Commission, that it complied with APB 25 and that it had properly accounted for its option grants using the intrinsic value method prescribed by APB 25. As SafeNet's CFO, and later its interim CFO, Argo signed annual and quarterly reports that falsely certified that SafeNet had complied with APB 25 and had properly accounted for option grants.

B. SafeNet's Option Granting Process

13. When Argo assumed the duties as CFO of SafeNet, several independent SafeNet directors comprised the Compensation Committee, which among other things was authorized to award stock options under SafeNet's stock option plans. During 1999 and the first half of 2000, the Compensation Committee primarily awarded options grants when it convened during regularly scheduled meetings of SafeNet's Board of Directors. Sometime after mid-2000, SafeNet amended its procedure for granting options and allowed a grant to be awarded by the unanimous written consent of the Compensation Committee.

14. Pursuant to SafeNet's stock options plan in effect during this period, the "grant date" was defined as "the date on which the [Compensation] Committee formally acts to grant an Award to a grantee or such other date as the [Compensation] Committee shall so designate at the time of taking such formal action." However, if the Compensation Committee granted in-the-

money options as a result of selecting an historical date as the “grant date,” GAAP required SafeNet to calculate compensation expense for the in-the-money portion of the options and amortize it over the vesting period of the options.

15. After Argo began working at SafeNet, Argo and SafeNet’s then chief executive officer (“Former CEO”) made recommendations to the Compensation Committee, concerning the specific employees or executives who should receive stock options and the number of options to be granted. The Compensation Committee would then award the grants, if appropriate.

16. In May 2000, Argo and the former CEO drafted and sent a memorandum to the Compensation Committee requesting that it approve a standardized option plan that would permit SafeNet’s management to grant stock options without the necessity of obtaining the approval of the Compensation Committee. The proposed standardized plan, which applied to new hires, promoted employees, and employees receiving “refresher grants” (grants issued to keep compensation levels equitable among employees), required the Compensation Committee to establish standard option grants for each category of employees. In this memorandum, Argo and the former CEO stated that, because the accounting rules concerning stock option compensation had become more stringent, SafeNet needed to establish procedures to ensure that stock options were issued “without a charge to compensation expense.” The accounting changes referred to in the memo related to Financial Interpretation No. 44 (“FIN 44”), which was issued by the Financial Accounting Standards Board in March 2000 and became effective July 1, 2000. FIN 44 is an interpretation of APB 25, and addressed issues relating to the expensing of stock options and embodied the current view of GAAP treatment of accounting for stock option compensation.

17. On July 19, 2000, SafeNet's Board of Directors adopted a uniform option program for newly hired employees and employees receiving promotions that delegated to SafeNet's CEO, CFO, and Secretary, the authority to issue stock options in accordance with specific guidelines specified by the Board. Any stock option award that did not comply with the guidelines of the uniform option program required the written unanimous consent of the Compensation Committee.

18. Also, on July 19, 2000, SafeNet's Board of Directors approved an annual stock option program for employees receiving so-called "refresher" or "replenishment" grants and apparently delegated to SafeNet's CEO, CFO, and Secretary the authority to issue these stock options in accordance with the guidelines specified by the Board. Any replacement stock option award pursuant to this program that did not comply with the guidelines of the annual option program required the written unanimous consent of the Compensation Committee.

19. The Board of Directors, however, did not delegate to SafeNet's CEO, CFO or Secretary the authority to grant stock options to themselves or other senior officers. Consequently, such grants continued to be awarded solely by the Compensation Committee.

20. Notwithstanding the delegations of authority described in paragraphs 17 and 18 above, Argo routinely submitted proposed stock option grants to the Compensation Committee to have the options granted by the committee.

C. Argo Directed the Backdating

21. Argo, in her capacity as SafeNet's CFO, was responsible for supervising SafeNet's stock option granting process, and obtaining the written consent of the Compensation Committee for stock option grants as necessary.

22. Beginning not later than October 2000, Argo's practice was to direct an administrative assistant to prepare the written consent for the grant of a stock option by the Compensation Committee. Argo provided the administrative assistant with the pertinent information for the consents, including the name of the stock option recipient, the number of options to be granted, and the grant date to be used. To select the date to be used as the grant date, Argo, or an administrative assistant acting at Argo's direction, looked back to find dates when SafeNet's stock had closed at or near the low for that quarter. After Argo reviewed and approved the draft consents, either Argo or the administrative assistant acting on Argo's instructions, forwarded the consents to the Compensation Committee to have the options granted. The purported grant date for stock option grants was typically placed at the top of the written consents, with the consents stating that certain individuals named in the consents or in an attachment to the consents were granted a specified number of options as of the particular date at the top of the consents. In addition, the consents typically stated that the exercise price for the option was "the last sale price of the Company's Common Stock on the NASDAQ National Market, on the above listed date."

23. The dates on the written consents submitted to the Compensation Committee were selected by Argo, or by an administrative assistant at Argo's direction, because they were historical dates on which the closing price of SafeNet's stock was particularly low, often at or near the quarterly low closing price for the stock. These backdated consents, prepared by Argo, or at her direction, created the false appearance that the dates reflected at the top of the consents were the actual dates when the options were granted by the Compensation Committee.

24. Argo did not disclose to the Compensation Committee that she routinely looked back and chose dates that coincided with particularly low stock prices as the grant dates for option grants.

25. During the period from the fourth quarter of 2000 through the second quarter of 2004, at Argo's direction, numerous option grants were backdated and presented to the Compensation Committee in order to grant her, and other employees, in-the-money options at or near low prices for SafeNet's stock. Based on her illegal conduct, Argo was awarded a total of at least 98,000 in-the-money SafeNet options, at exercise prices that coincided with particularly low closing prices for SafeNet stock on each of the following dates: (i) October 11, 2000 (13,000 options at an exercise price of \$24.12--the lowest closing price for SafeNet stock for that quarter); (ii) October 1, 2001 (45,000 options at an exercise price of \$5.85--the lowest closing price for that quarter); (iii) February 27, 2003 (30,000 options at an exercise price of \$16.47-- the lowest closing price for that quarter); and (iv) July 17, 2003 (10,000 options at an exercise price of \$31.35--one of the lowest closing prices for that quarter). Argo's illicit conduct also resulted in other senior executives and employees being awarded at least 840,000 in-the-money stock options, at exercise prices that coincided with particularly low closing prices for SafeNet stock on at least each of the following dates: October 11, 2000, April 3, 2001, October 1, 2001, October 8, 2002, February 27, 2003, and July 17, 2003.

26. Argo knowingly or recklessly failed to cause SafeNet to record the requisite compensation expense for these in-the-money option grants.

27. In June 2004, Argo was promoted to president and COO of SafeNet, and a New CFO ("New CFO") was hired. In an e-mail dated September 15, 2004, Argo informed the New CFO of her past practice of backdating option grants as follows:

Our past practice has been to aggregate options for performance awards or new hires in the quarter and pick the best price after the hire date. We then send the unanimous consent to the comp committee and the options are approved. I think this is a good practice because of the volatility of our stock price. Who wants to have an option priced on your start date and then have the option underwater a month later when you are notified of the award price.

After Argo's promotion, the practice of backdating option grants continued.

28. During the period in which Argo engaged in the backdating of options grants, Argo had frequent interactions with SafeNet's independent auditors, and discussed various option accounting issues with them. However, Argo never disclosed to SafeNet's independent auditors that she routinely looked back to find favorable dates that coincided with particularly low stock prices to use as the grant dates for option grants. Nor did she disclose to SafeNet's auditors that the date at the top of the consents signed by the Compensation Committee was not the date on which the committee had granted the options.

29. Beginning in the fourth quarter of 2000 through the second quarter of 2004, and in her capacity as SafeNet's Interim CFO beginning in the first quarter of 2006, Argo signed management representation letters that asserted to SafeNet's auditors that Argo was unaware of any ongoing fraud at SafeNet. Argo knew or was reckless in not knowing that such misrepresentations were false and misleading.

D. Argo Benefited from the Backdating Scheme

30. Argo directly benefited from her backdating scheme when she obtained in-the-money option grants from SafeNet. The in-the-money portion of these backdated options that Argo received was worth approximately \$960,000 at the time of the grants to Argo. Each of Argo's option grants had a four-year vesting period with twenty-five percent of the option vesting each year.

