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1 MARC J. FAGEL (Cal. Bar No. 154425)
fagelm@sec.gov
2 ROBERT L. MITCHELL (Cal. Bar No. 161354)
mitchellr@sec.gov
3 MICHAEL S. DICKE (Cal. Bar No. 158187)
dickem@sec.gov
4 SHEILA E. O'CALLAGHAN (Cal. Bar No. 131032)
ocallaghans@sec.gov
5 SAHIL W. DESAI (Cal. Bar No. 197358)
desais@sec.gov

6 Attorneys for Plaintiff
7 SECURITIES AND EXCHANGE COMMISSION
44 Montgomery Street, Suite 2600
8 San Francisco, California 94104
Telephone: (415) 705-2500
9 Facsimile: (415) 705-2501

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

HRL

C 07 2214

14 SECURITIES AND EXCHANGE COMMISSION,
15 Plaintiff,
16 vs.
17 NANCY R. HEINEN and FRED D. ANDERSON,
18 Defendants.

Case No.

COMPLAINT

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

21 SUMMARY OF THE ACTION

22 1. This matter involves improper stock option backdating at Apple Computer, Inc. ("Apple"
23 or the "Company"), which resulted in the Company's issuance of false financial statements that
24 concealed millions of dollars in executive compensation. On two occasions in 2001, Apple issued
25 huge option grants to top executives, but used false grant dates to avoid reporting nearly \$40 million
26 in expenses to the public. Defendant Nancy R. Heinen, Apple's then-General Counsel, caused the
27 options to be backdated and altered company records to conceal the fraud. Defendant Fred D.
28

1 Anderson, Apple's then-Chief Financial Officer, should have noticed Heinen's efforts to backdate the
2 first grant but failed to take steps to ensure that Apple's financial statements were correct. The two
3 defendants personally benefited from the backdating, receiving several million dollars in unreported
4 compensation as a result of the backdated options.

5 2. Under well-settled accounting principles in effect throughout the relevant period, Apple
6 was not required to record an expense in its financial statements for options granted at the market
7 price ("at-the-money"), but *was* required to record expenses for any options granted below the current
8 market price ("in-the-money"). In order to provide herself and other Apple executives with far more
9 lucrative in-the-money options, while avoiding having to inform shareholders of the millions of
10 dollars in compensation expenses, Heinen twice engaged in a scheme to grant in-the-money options
11 while falsifying records to make it appear that the options had been granted at-the-money. In
12 connection with a 4.8 million-share grant to Apple's Executive Team, and a 7.5 million-share grant to
13 Chief Executive Officer Steven Jobs, Heinen backdated the grants to dates on which the stock was
14 trading at significantly lower prices. In each instance, Heinen fabricated or falsified company records
15 to create the false appearance that the options had been granted at the market price on an earlier date
16 – including the creation of minutes for a non-existent Board of Directors meeting at which the Jobs
17 grant was supposedly authorized. For the Executive Team grant, Anderson should have recognized
18 the implications of the backdated grant, put a stop to it, and disclosed it to Apple's auditors, KPMG
19 LLP ("KPMG"), but failed to do so.

20 3. As a result, Heinen's and Anderson's actions caused Apple to materially understate its
21 expenses, overstate its income, and falsely represent in certain filings that Apple had incurred no
22 expense for options grants.

23 4. By engaging in the acts alleged in this Complaint, defendants Heinen and Anderson,
24 among other things, violated the antifraud provisions of the federal securities laws, made or caused to
25 be made materially false or misleading statements to Apple's auditors, falsified books and records,
26 and caused Apple to falsely report its financial results. The Commission seeks an order enjoining
27 defendants from future violations of the securities laws, requiring them to disgorge ill-gotten gains
28 with prejudgment interest and to pay civil monetary penalties, barring Heinen from serving as an

1 officer or director of a public company, and providing other appropriate relief.

2 JURISDICTION AND VENUE

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

6 6. This Court has jurisdiction over this action pursuant to Sections 20(c) and 22(a) of the
7 Securities Act [15 U.S.C. §§ 77t(c) and 77v(a)] and Section 27 of the Exchange Act [15 U.S.C. §
8 78aa]. The defendants, directly or indirectly, have made use of the means and instrumentalities of
9 interstate commerce, of the mails, or of the facilities of a national securities exchange in connection
10 with the acts, practices and courses of business alleged in this complaint.

11 7. Venue is proper in this District pursuant to Section 22 of the Securities Act [15 U.S.C. §
12 77v], and Section 27 of the Exchange Act [15 U.S.C. § 78aa]. Heinen and Anderson both reside in
13 the Northern District of California, and acts or transactions constituting violations occurred in this
14 district.

15 INTRADISTRICT ASSIGNMENT

16 8. Assignment to the San Jose Division is appropriate pursuant to Civil Local Rules 3-2(c)
17 and 3-2(d) because acts and omissions giving rise to the Commission’s claims occurred, among other
18 places in this district, in Santa Clara County.

19 DEFENDANTS

20 9. Nancy R. Heinen, age 50, resides in Portola Valley, California. She has maintained an
21 active license to practice law in California since 1982. At the time of the events alleged in the
22 complaint, Heinen was Senior Vice President, General Counsel, and Corporate Secretary at Apple.
23 In that position, among other things, Heinen had responsibility for overseeing Apple’s legal group
24 and preparing and certifying the minutes of Apple’s Board of Directors and its committees. Heinen
25 left Apple in May 2006. In sworn testimony during the Commission’s investigation, Heinen declined
26 to answer questions based on her rights under the Fifth Amendment.

27 10. Fred D. Anderson, age 62, resides in Atherton, California and was a licensed Certified
28 Public Accountant in the State of California from 1975 to 1998. At the time of the events alleged in

1 the complaint, Anderson was Apple's Chief Financial Officer. After retiring from Apple in 2004,
2 Anderson began serving as an Apple director, a position he held until his resignation from the Board
3 in September 2006.

4 **RELEVANT ENTITY**

5 11. Apple is a Delaware corporation headquartered in Cupertino, California, located in Santa
6 Clara County. Apple designs, develops, manufactures, and markets personal computers, portable
7 digital music players, and related products. At the time of the events alleged in this complaint, Apple
8 had common stock registered with the Commission pursuant to Section 12(b) of the Exchange Act
9 [15 U.S.C. § 78l(b)], which was listed on the NASDAQ National Market.

10 **FACTUAL ALLEGATIONS**

11 *Apple's Options Granting Program*

12 12. During the late 1990s and early 2000s, Apple, like many other companies, made liberal
13 use of employee stock options as a form of compensation to recruit, retain, and incentivize key
14 employees. Each option gave the grantee the right to buy one share of Apple common stock from the
15 Company at a set price, called the "exercise" or "strike" price, on a future date after the option vested.
16 The option was "in-the-money" whenever the trading price of Apple's common stock exceeded the
17 option's exercise price. The option was "at-the-money" whenever the trading price of Apple's
18 common stock and the exercise price were the same. The option was "underwater" or "out-of-the-
19 money" whenever the trading price of Apple's common stock was less than the exercise price.

20 13. Under the accounting rules in effect from the time Apple became a public company, U.S.
21 public companies were permitted to grant stock options to employees without recording an expense
22 so long as the options' strike price was at or above the market's closing price for the stock on the day
23 the options were granted. However, when granting options in-the-money – that is, with a strike price
24 below the market price when granted – public companies were required to record a compensation
25 expense in their financial statements. Consequently, granting in-the-money options to employees
26 could have a significant impact on the expenses and income (or loss) reported to the shareholders of a
27 public company.

1 14. Throughout the relevant period, Apple represented, in audited financial statements and
2 other filings with the Commission, that its option grants were made at fair market value, *i.e.*, the
3 closing trading price of Apple common stock on the option's "measurement date," which is the date
4 when the key terms of the options grant are fixed.

5 **The January 17, 2001 Executive Team Grant**

6 15. In early February 2001, Apple finalized the terms of a 4.8 million options grant to six
7 members of its Executive Team, including one million options for Anderson and 400,000 for Heinen.
8 At that time, Apple stock was trading at nearly \$21 per share. However, Heinen caused Apple to
9 backdate the grant to the Executive Team to January 17, 2001, when Apple's share price was only
10 \$16.81, and the strike price for the grant was set at this substantially lower price. Heinen also
11 directed her staff to prepare documents that falsely indicated that Apple's Board had approved the
12 Executive Team grant on January 17. By so doing, Heinen caused Apple to improperly fail to record
13 approximately \$18.9 million in compensation expense associated with the in-the-money Executive
14 Team grant. Anderson was aware of the manner in which the price of the Executive Team grant was
15 selected, and its impact on Apple's reported compensation expense should have been clear to him.

16 **A. Heinen Picks An Earlier Date and Price for the Executive Team Grant**

17 16. Around late 2000, Apple's Board had begun considering a large options grant to Apple's
18 Executive Team. On January 30, 2001, Heinen provided Jobs with a list of the daily closing share
19 prices of Apple's common stock for January 2001 and suggested that Apple use an earlier date and
20 price for the Executive Team options grant.

21 17. In her January 30 e-mail, Heinen wrote: "There are 6.68m shares available for grant in
22 the 1998 Executive Officer plan. To avoid any perception that the Board was acting in appropriately
23 [sic] for insiders prior to Macworld announcements, I suggest we use Jan. 10, the day after your
24 Macworld keynote, at \$16.563. That was one of the lowest closes of the month, after the \$14.875
25 price on Jan 2. I don't think the [Executive Team] would object to the \$1.688 difference to avoid
26 claims of inappropriate conduct."

27 18. On January 31, 2001, Heinen sent the same set of January closing prices to Anderson and
28 recommended picking Tuesday, January 17 or Monday, January 22 as ostensible grant dates. Heinen

1 subsequently corrected her earlier e-mail, noting that the 16th actually fell on a Tuesday. Anderson
2 replied that “Tuesday the 16th looks fine to me.”

3 19. The following day, February 1, 2001, Heinen told Anderson that Jobs had agreed to use
4 Apple’s closing price on January 17th for the Executive Team grant. Heinen began the process of
5 preparing false paperwork to submit to Apple’s Board of Directors so that it could authorize the
6 grant. That same day, Heinen directed a lawyer in Apple’s Legal Department to prepare a
7 Unanimous Written Consent (“UWC”) for the Board members’ signature, with “an effective date of
8 Jan 17, 2001, priced at \$16.813.” Contrary to these representations, no actual Board action was taken
9 on January 17, and Heinen only began the process of selecting the grant date and price on January 30.

10 20. Once the UWC was finalized, Heinen then forwarded the options grant paperwork to
11 Apple’s Board, with a copy to Anderson. Heinen’s cover memorandum (dated February 1) asked the
12 Board to sign and return the UWC to her by fax, “if approved.” Apple’s directors subsequently
13 signed the UWCs and returned them to Heinen.

14 21. Heinen received the UWCs by February 7, 2001. Apple’s stock closed at \$20.75 per share
15 on that date, approximately \$3.94 higher than the January 17 price used for the Executive Team
16 grant. As a result, the Executive Team grant was in-the-money by approximately \$3.94 per share
17 when granted.

18 **B. The Executive Team Grant Backdated to January 17, 2001 Caused Apple’s Filings with**
19 **the Commission to be False**

20 22. As a public company, Apple filed with the Commission annual reports that included
21 audited financial statements, certified by the Company’s outside auditors, KPMG. Apple’s public
22 filings affirmatively stated that the Company accounted for stock options granted to employees in
23 accordance with generally accepted accounting principles, also known as GAAP, which are the
24 accounting conventions, standards, and rules required for preparing financial statements. GAAP
25 required an expense to be recorded for stock options granted at prices below the market value for the
26 stock on the date of the grant.

27 23. Throughout the period, Apple accounted for stock options using APB 25. Under APB 25,
28 employers were required to record an expense on their financial statements for the in-the-money

1 portion of any options grant. An option with an exercise price lower than the quoted market price on
2 the date of actual grant is considered in-the-money. According to APB 25, that difference must be
3 recorded as compensation expense to be recognized over the vesting period of the option. APB 25
4 allowed companies, where the key terms of an option grant were certain, to grant employee stock
5 options without recording any compensation expense so long as the option exercise price was not
6 below the stock's market price on the date of the grant.

7 24. Apple's failure to record a compensation expense in connection with the Executive Team
8 grant resulted in overstated income on the financial statements in its Forms 10-K for fiscal year 2001,
9 ended September 29, 2001, and fiscal year 2002, ended September 28, 2002. For fiscal year 2001,
10 the failure to record a compensation expense for the January grant caused Apple's net loss to be
11 understated by 10.77%; for fiscal 2002, the failure to record an expense caused operating income to
12 be overstated by 23.5% and net income by approximately 5%. Apple also sold securities pursuant to
13 offering documents, including registration statements on Forms S-8 filed May 18, 2001, September
14 28, 2001, December 24, 2001, and December 24, 2002, which incorporated the false financial
15 statements. In such filings, Apple also falsely disclosed that it did not recognize any compensation
16 expense for options because it did not grant in-the-money options. At this time, Heinen and
17 Anderson both reviewed Apple's financial statements for accuracy and completeness prior to filing.

18 25. Apple's proxy statements (which were sent to its shareholders) for fiscal year 2001, filed
19 March 21, 2002, and fiscal year 2002, filed March 24, 2003, contained false disclosures. Among
20 other things, the discussion on executive compensation falsely states that the Executive Team
21 received their options "at an exercise price equal to the fair market value of the Common Stock on
22 the date of grant" and that the date of grant was January 17, 2001. At this time, Heinen assisted with
23 the preparation of Apple's proxy statements, and Heinen and Anderson both reviewed the statements
24 for accuracy and completeness prior to filing.

25 26. After the grant had been issued, KPMG, Apple's auditors, received a copy of the
26 backdated January 17, 2001 UWC confirming the Executive Team grant. Heinen and Anderson were
27 both aware that Apple routinely provided UWCs to KPMG in connection with its audit work.
28

1 27. In addition, Anderson signed a management representation letter dated October 16, 2001
2 to KPMG for fiscal year 2001 indicating that the company's stock options were "granted at fair value
3 at the date of grant." Because he knew the manner in which the January 17, 2001 date was selected
4 for the Executive Team grant, Anderson should have known that these statements were inaccurate.

5 28. Heinen and Anderson both signed and caused to be filed with the Commission false
6 Forms 5 (disclosing their annual statements of changes in beneficial ownership of Apple securities)
7 that incorrectly disclosed the grant date for their options grants as January 17, 2001.

8 **C. Heinen and Anderson Were Aware That In-the-Money Grants Needed to be Expensed**

9 29. Heinen understood the accounting implications of awarding an in-the-money options
10 grant. She knew that Apple would have to record an accounting expense for any options that were
11 granted below fair market value on the date of the grant. She also knew the requirements for the
12 determination of a measurement date for grants.

13 30. Anderson also understood that Apple would have to appropriately account for an in-the-
14 money grant. A former certified public accountant, Anderson was familiar with Accounting
15 Principles Board Opinion 25, "Accounting for Stock Issued to Employees" ("APB 25"), the
16 accounting literature that dictates how to account for the granting of an in-the-money stock option.

17 **D. Heinen and Anderson Received Ill-Gotten Gains from the Backdated Grants**

18 31. Pursuant to the backdated Executive Team grant, Heinen and Anderson received grants
19 that were in-the-money by approximately \$3.94 per share. Anderson exercised and sold 750,000 of
20 the 1,000,000 shares granted to him before he retired from Apple in 2004; Heinen exercised and sold
21 all 400,000 options she received. At a minimum, Heinen and Anderson reaped improper benefits of
22 approximately \$1.6 million and \$3 million, respectively.

23 32. Heinen was also unjustly enriched, through, among other things, the exercise of additional
24 stock options and the sale of Apple stock at prices fraudulently inflated as a result of Apple's false
25 financial statements.

26 **The October 19, 2001 Steve Jobs Grant**

27 33. On December 18, 2001, Apple and Steve Jobs concluded lengthy negotiations over the
28 terms of a 7.5 million share options grant to Jobs. At that time, the share price of Apple stock was

1 \$21.01. However, Heinen backdated the grant to Jobs to October 19, 2001, when Apple's share price
2 was only \$18.30, and the strike price for the grant was set at this substantially lower price. Heinen
3 also created fictitious Board minutes that purported to show that the Board had approved the grant to
4 Jobs on October 19 at a "Special Meeting," which never occurred. By so doing, Heinen caused
5 Apple to improperly fail to record \$20.3 million in compensation expense associated with the in-the-
6 money options grant to Jobs.

7 **A. Heinen Backdates the 7.5 Million Option Grant to Steve Jobs**

8 34. Beginning in the spring of 2001, Apple's Board began considering ways to increase Jobs's
9 compensation. Since returning to Apple in July 1997, Jobs had been paid only \$1 a year
10 in compensation for his services. Although he had received a grant of 10 million options in January
11 2000, those options were significantly underwater as a result of declines in Apple's stock price.

12 35. On August 29, 2001, Apple's Board granted options for Jobs to purchase 7.5 million
13 shares of Apple common stock at an exercise price of \$17.83 per share, the closing price of Apple's
14 stock on that day.

15 36. Shortly after the Board approved the 7.5 million option grant, Jobs expressed
16 dissatisfaction with its vesting schedule. Over the course of the next three months, Apple's
17 Compensation Committee spoke frequently amongst themselves and with Jobs about the grant,
18 holding multiple discussions and conference calls, including Compensation Committee meetings on
19 October 16 and 19 and November 19 and 20. Heinen was aware of and involved in these discussions,
20 and she attended the Compensation Committee meetings in her role as Corporate Secretary.

21 37. As the Compensation Committee's discussions with Jobs continued, Heinen became
22 increasingly concerned about the delay. Apple had missed the November deadline by which Apple
23 was supposed to file a Form 4 with the SEC reporting the specifics of Jobs's August 29 options grant.
24 In addition, Heinen also foresaw a problem with the auditors, since Apple's fiscal year had concluded
25 at the end of September, yet Apple had not disclosed the grant to KPMG.

26 38. By mid-December, it was evident to Heinen that the August 2001 grant date would no
27 longer withstand scrutiny. Instead, she began to consider the possibility of selecting a different grant
28 date in the new fiscal year. On December 17 – by which time Apple's stock price had risen

1 significantly – Heinen forwarded a spreadsheet to the chair of Apple’s Compensation Committee
2 detailing three months of Apple’s closing prices and recommending the selection of a day for the
3 backdated options grant. She wrote: “There are several days in October and November, following
4 the first meeting of the Compensation Committee on October 16th and after our earnings call on
5 October 17th, that are close to the Aug. 29th close of \$17.83. I suggest using a day that the
6 Compensation Committee held a telephone call, either jointly or individually with the members.”

7 39. On December 18, 2001, the Compensation Committee and Jobs finally came to an
8 agreement on the vesting schedule for the 7.5 million share grant. The following day, the chair of the
9 Compensation Committee e-mailed Apple’s full Board to let them know the specifics of the grant,
10 including the fact that the date of grant would be October 19, 2001, which corresponded to the date of
11 a Compensation Committee call. He noted: “For the record, I informed Nancy [Heinen] in advance
12 of our intentions and of the above specifics to be certain we were conforming to all legal
13 requirements/guidelines.” Heinen received a copy of the e-mail.

14 40. On December 18, 2001, Apple’s common stock closed at \$21.01. Hence, by retroactively
15 repricing the grant to October 19 (when the stock closed at \$18.30), Heinen caused Apple to award
16 Jobs 7.5 million in-the-money options while avoiding reporting approximately \$20.3 million in pre-
17 tax compensation expense.

18 **B. Heinen Creates False Corporate Documents**

19 41. To substantiate October 19, 2001 as the grant date for Jobs’s grant, Heinen had fictitious
20 minutes created for a phony “Special Meeting” of Apple’s Board of Directors. Minutes purporting to
21 be from the October 19, 2001 Special Meeting state that all of the Board members (other than Jobs)
22 met to discuss CEO compensation. According to the minutes, the Board voted to approve a grant to
23 Jobs of an option to purchase 7.5 million shares at an exercise price equal to the closing price on the
24 date of the grant (October 19). In fact, no such meeting occurred.

25 42. Heinen directed her staff to prepare the “Special Meeting” minutes in January 2002. After
26 the draft was prepared, Heinen reviewed and signed the minutes as Corporate Secretary, falsely
27 certifying that the minutes were accurate.

1 50. For Apple's 2002 fiscal year, the failure to record an expense associated with the in-the-
2 money portions of the Executive Team grant and the Jobs grant resulted in a combined 71%
3 overstatement of reported operating income and a combined 16% overstatement of reported net
4 income.

5 **FIRST CLAIM FOR RELIEF**

6 *(Violations of Section 10(b) of the
Exchange Act and Rule 10b-5 Thereunder by Heinen)*

7 51. The Commission realleges and incorporates by this reference Paragraphs 1 through 50,
8 above.

9 52. By engaging in the conduct described above, Heinen, directly or indirectly, in connection
10 with the purchase or sale of securities, by the use of means or instrumentalities of interstate
11 commerce, or the mails, with scienter:

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

19 53. By reason of the foregoing, Heinen has violated, and unless restrained and enjoined, will
20 continue to violate Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R.
21 § 240.10b-5].

22 **SECOND CLAIM FOR RELIEF**

23 *(Aiding and Abetting Violations of Section 10(b) of the
Exchange Act and Rule 10b-5 Thereunder by Heinen)*

24 54. The Commission realleges and incorporates by this reference Paragraphs 1 through 50,
25 above.

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

1 aiding and abetting violations of Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 14(a) of the Exchange
2 Act [15 U.S.C. §§ 78m(a), 78m(b)(2)(A), 78m(b)(2)(B), and 78n(a)] and Rules 12b-20, 13a-1, 13a-
3 13, and 14a-9 [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-13, and 240.14a-9] thereunder;

4 III.

5 Prohibit Heinen, pursuant to Section 21(d)(2) of the Exchange Act [15 U.S.C. § 78u(d)(2)],
6 from serving as an officer or director of any entity having a class of securities registered with the
7 Commission pursuant to Section 12 of the Exchange Act [15 U.S.C. § 78l] or that is required to file
8 reports pursuant to Section 15(d) of the Exchange Act [15 U.S.C. § 78o(d)];

9 IV.

10 Order defendants Heinen and Anderson to disgorge any wrongfully obtained benefits, including
11 prejudgment interest.

12 V.

13 Order Heinen and Anderson to pay civil penalties pursuant to Section 20(d) of the Securities
14 Act [15 U.S.C. § 77t(d)] and Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)].

15 VI.

16 Retain jurisdiction of this action in accordance with the principles of equity and the Federal
17 Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that
18 may be entered, or to entertain any suitable application or motion for additional relief within the
19 jurisdiction of this Court.

20 VII.

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

22
23 DATED: April 23, 2007

Respectfully Submitted,

24
25 

26 Sahil W. Desai

Attorney for Plaintiff

27 SECURITIES AND EXCHANGE COMMISSION
28