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U.S. SECURITIES AND EXCHANGE COMMISSION

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9 UNITED STATES DISTRICT COURT
10 NORTHERN DISTRICT OF CALIFORNIA
11 SAN FRANCISCO DIVISION
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14 U.S. SECURITIES AND EXCHANGE)
COMMISSION,)

15 Plaintiff,)

16 v.)

17 MATTHEW MING-CHANG CHIANG,)

18 Defendant.)

No. C 04-04145 SI

PLAINTIFF SECURITIES AND
EXCHANGE COMMISSION'S
COMPLAINT FOR PERMANENT
INJUNCTION AND OTHER
EQUITABLE RELIEF

19 DEMAND FOR JURY TRIAL

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

21 **SUMMARY OF ACTION**

22 1. This enforcement action arises from the false reporting by Clarent Corporation ("Clarent")
23 of about \$36 million in phony revenue in its annual and quarterly filings with the Commission during
24 2000 and 2001 and the overstatement of \$25 million in cash assets in Clarent's quarterly filing for its
25 June 2001 fiscal quarter. Defendant Matthew Ming-Chang Chiang ("Chiang") instigated a significant
26 amount of the company's false revenue reporting while managing its Asia Pacific Region. He also
27 participated in Clarent's overstatement of net income and assets and in the violation of Clarent's internal
28 controls.

1 2. During the fourth fiscal quarter of the year ended December 31, 2000, Chiang participated
2 in oral promises to a Taiwanese customer that if the customer placed a \$7.2 million order for Clarent
3 product, but could not sell the product, Clarent would have Artacula Corporation (“Artacula”), which
4 Chiang’s family controlled, purchase the unsold product. During the fiscal quarter ended March 31,
5 2001, Chiang authorized a \$6 million sales contract with another Taiwanese customer who wanted only
6 \$500,000 in product and who received Chiang’s authorization to cancel the contract and return the
7 product. Similarly, during the fiscal quarter ended June 30, 2001, Chiang authorized sales contracts
8 totaling nearly \$19 million with three Asian customers who told Chiang that they did not need the product
9 and who received his authorization to cancel their contracts.

10 3. Because these contracts did not require the customers to keep and pay for the product
11 from Clarent, Chiang knew that those purported “sales” could not be reported as revenue by Clarent in
12 its earnings announcements and filings with the Commission. Chiang nonetheless authorized those sales
13 contracts and then withheld information about the improper contract terms from Clarent’s corporate
14 headquarters in the United States. Chiang therefore engaged in a fraudulent scheme to have Clarent
15 report inflated sales revenue for his Asia Pacific Region in violation of both Generally Accepted
16 Accounting Principles (“GAAP”) and the federal securities laws. Additionally, in late June 2001, Chiang
17 directed the transfer of \$25 million to Artacula, which his family controlled, despite Clarent’s written
18 procedures prohibiting such a transfer and despite the lack of any documentary justification for the
19 payment. As a result, the \$25 million should have been removed from the reported cash balances on
20 Clarent’s June 2001 financial statements and then treated as a refund and/or expense so as to reduce the
21 company’s reported assets and net income.

22 4. Chiang’s scheme began to unravel when falsified banking documents were discovered and
23 when customers insisted upon returning their unwanted product to Clarent. In September 2001, Clarent
24 announced that its revenue might have been overstated and that it had placed Chiang, and two other high-
25 level executives, on administrative leave while it conducted an internal investigation. Officials at
26 NASDAQ then suspended trading in Clarent’s shares, and eventually delisted the company. Clarent later
27 issued an accounting restatement that eliminated most of the company’s revenue for a number of periods,
28 including those ended December 31, 2000, March 31, 2001 and June 30, 2001. In the end, Clarent’s

1 shareholders lost nearly the total value of their investment in the company.

2 5. Given the fraud perpetrated by Chiang upon Clarent's shareholders and the securities
3 markets, the Commission brings this action to obtain a permanent injunction prohibiting Chiang's further
4 violations of the federal securities laws, to force him to disgorge his ill-gotten gains, to bar him from
5 serving as an officer or director of a publicly reporting company and to impose civil monetary penalties.

6 **JURISDICTION AND VENUE**

7 6. The Commission brings this action pursuant to Sections 21(d) and 21(e) of the Securities
8 Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. §§ 78u(d) and 78u(e)]. This Court has
9 jurisdiction over this action pursuant to Sections 21(e) and 27 of the Exchange Act [15 U.S.C. §§ 78u(e)
10 and 78aa].

11 7. Chiang, directly or indirectly, made use of the means and instrumentalities of interstate
12 commerce, of the mails, or of the facilities of a national securities exchange, in connection with the acts,
13 practices, and courses of business and transactions alleged herein.

14 8. This district is an appropriate venue for this action under Section 27 of the Exchange Act
15 [15 U.S.C. § 78aa]. Certain of the transactions, acts, practices and courses of business constituting the
16 violations alleged herein occurred within the Northern District of California.

17 9. Assignment to the San Francisco Division is appropriate pursuant to Civil Local Rule
18 3-2(d) because a substantial part of the events that give rise to the Commission's claims occurred in San
19 Mateo County, where Clarent was headquartered.

20 **BACKGROUND ALLEGATIONS**

21 ***Clarent's Business Activities and Reporting Obligations***

22 10. Clarent was originally organized in 1996 in the State of California under the name
23 "NetiPhone, Incorporated." The company changed its name in May 1997 to "Clarent Corporation," and
24 was reincorporated in June 1999 in the State of Delaware. Clarent's corporate headquarters are in
25 Redwood City, California. At the current time, Clarent is a corporate shell without any business
26 operations. Previously, Clarent developed, sold and serviced software and hardware products designed
27 to manage the transmission of voice and data over the internet.

28 11. Clarent held its initial public offering on July 1, 1999, and registered its common stock

1 with the Commission pursuant to Section 12(g) of the Exchange Act. Clarent's shares traded on the
2 NASDAQ National Market under the symbol "CLRN" until NASDAQ suspended trading in September
3 2001 and delisted the shares in January 2002. Subsequently, Clarent's shares have traded on the "Pink
4 Sheets" over-the-counter market.

5 12. As a publicly traded company, Clarent was required to comply with various Commission
6 regulations designed to ensure that the company accurately recorded and reported its financial results to
7 investors. Those Commission regulations obligated Clarent to report its financial results on a quarterly
8 basis in a Form 10-Q quarterly report and on an annual basis in a Form 10-K annual report. Those
9 regulations also required Clarent to comply with GAAP in reporting its financial results.

10 13. The Commission's regulations and accounting guidelines moreover required Clarent to
11 adopt critical accounting policies. Clarent therefore has the following revenue recognition policy, which
12 was disclosed in its Form 10-K annual report for the year ended December 31, 2000: "Revenue is
13 recognized at the time of shipment of the products when persuasive evidence of an arrangement exists,
14 the fee is fixed and determinable, when no significant contractual obligations or acceptance terms, if any,
15 remain outstanding and collection of the resulting receivable is deemed probable." Under that policy and
16 GAAP, Clarent could not recognize revenue for any "contingent sale" whereby the customer did not have
17 a binding obligation to pay for, and keep, the product purchased.

18 14. In its quarterly and annual filings with the Commission, Clarent reported its revenue on
19 a consolidated basis for all of its worldwide sales regions. Clarent's filings also provided a breakdown
20 of the company's revenue for each of its geographic sales areas – the United States, the Other Americas,
21 the Asia Pacific Region and the combined Europe, Middle East and Africa Region. According to that
22 geographic breakdown, most of Clarent's revenue initially came from sales to customers in North
23 America. Over time, however, a rapidly increasing percentage of Clarent's revenue supposedly came
24 from sales to customers in its Asia Pacific Region.

25 15. During the 1999 fiscal year, Clarent reported \$20,365,000 in revenue in the United States
26 and \$15,999,000 revenue in the Asia Pacific Region. During the 2000 fiscal year, Clarent reported
27 \$34,695,000 in revenue in the United States and a much higher \$67,172,000 in revenue in the Asia
28 Pacific Region.

1 16. The purported growth in Clarent's sales in the Asia Pacific Region supposedly continued
2 during the 2001 fiscal year. In the Form 10-Q quarterly report for the fiscal quarter ended March 31,
3 2001, Clarent reported total quarterly revenue of \$61,192,000. When broken out by region, Clarent's
4 quarterly revenue in the United States was \$6,916,000, while its quarterly revenue in the Asia Pacific
5 Region was \$47,496,000. Similarly, in its Form 10-Q quarterly report for the quarter ended June 30,
6 2001, Clarent reported total quarterly revenue of \$63,152,000. Broken out by region, Clarent's quarterly
7 revenue for the United States had declined to \$4,114,000, while quarterly revenue for the Asia Pacific
8 Region had increased to \$49,078,000.

9 17. While under Chiang's management, the Asia Pacific Region was therefore reporting
10 virtually all of Clarent's revenue growth. Chiang joined Clarent in 1997 as a Marketing Director. In
11 September 2000, Chiang became a Clarent Vice President and the General Manager of its Asia Pacific
12 Region. During 2001, Chiang became a Clarent corporate officer and the President of its Asia Pacific
13 Region. As the General Manager and then President of Clarent's Asia Pacific Region, Chiang's prestige
14 and stature increased with his Region's growing revenue. Chiang reported to Jerry Shaw-Yau Chang
15 ("Chang"), who was at various times Clarent's President, Chief Executive Officer, Chairman of the Board
16 and Chief Strategist. Chiang held his positions until September 2001, when Clarent announced that it
17 had launched an internal investigation of the Asia Pacific Region's accounting and sales activities and
18 placed him on administrative leave. Clarent's internal investigation revealed that significant amounts
19 had been spent by the Taiwan office without the necessary authorizations and that much of the revenue
20 reported by the Asia Pacific Region was, in reality, improper and violated the company's revenue
21 recognition policy.

22 18. Chiang was a member of the board of directors of Artacula, which is a California
23 corporation with offices in Taipei, Taiwan and Milpitas, California. Artacula is affiliated with two
24 Taiwanese firms, Great MinCom Communications Corporation and Great MinCom Products
25 Corporation. For purposes of this Complaint, the name "Artacula" will cover the California corporation
26 and the two affiliated Taiwanese firms. From at least October 2000 until his death, Chiang's father was
27 Artacula's Chairman of the Board. After Chiang's father passed away, Chiang's mother became
28 Artacula's Chairman of the Board effective May 1, 2001. Given Chiang's personal and familial

1 connections with Articula and ability to exercise sufficient control over Articula to use it to further his
2 sales and revenue schemes at Clarent, Articula functioned as a related party of Clarent in any transaction
3 involving Clarent.

4 ***Matthew Chiang's Compensation and Financial Incentive to Commit Fraud***

5 ***The 2001 Sales Compensation Plan***

6 19. Chiang had a significant financial incentive to report higher sales in his Asia Pacific
7 Region, even if those sales were improper. Chiang's monetary compensation included a base salary and
8 a bonus opportunity. Additionally, Chiang participated in Clarent's 2001 Sales Compensation Plan (the
9 "Compensation Plan"). According to the Compensation Plan, Clarent set a \$120,000,000 revenue quota
10 for Chiang's Asia Pacific Region for the 2001 fiscal year. For revenue up to his \$120 million quota,
11 Chiang would receive a commission equal to 0.20% of the net revenue, payable thirty days after the
12 revenue was recorded. For revenue that was 101% to 150% of that quota amount, Chiang would receive
13 a commission equal to 0.70% of such net revenue. And for revenue that was over 151% of the annual
14 quota amount, Chiang would receive a commission of 1.20% of such net revenue.

15 20. The Compensation Plan specifically informed Chiang, however, that the "booking of
16 revenue will be consistent with [GAAP] and the revenue recognition practices of the Company." The
17 Compensation Plan also stated that the "Company must have a signed contract or valid purchase orders
18 that have no contingencies attached and are consistent with the Company's standard terms unless
19 approved by the President, Worldwide Sales of the Company." Additionally, the Compensation Plan
20 provided that lost revenue due to product returns would be deducted from Chiang's commissions.

21 ***The Stock Regrant Program***

22 21. Chiang also participated in Clarent's employee stock option program. In August 1997,
23 Clarent awarded Chiang options on 144,000 shares at an exercise price of \$0.05 per share. In August
24 1998, Clarent awarded Chiang options on another 50,000 shares at an exercise price of \$0.75 per share.
25 In June 1999, Chiang received options on another 10,000 shares at a \$15.00 per share exercise price.
26 Subsequently, in July 2000, Clarent awarded Chiang options on another 50,000 shares at an exercise price
27 of \$42.875 per share.

28 22. By late 2000 and early 2001, however, Clarent's stock price had fallen from over \$100

1 per share to a price in the low teens. Because many of its employee stock options were now “underwater”
2 due to the falling share price, Clarent adopted a “Regrant Program” in December 2000. Under the
3 Regrant Program, certain officers and other employees were allowed to cancel their “underwater” options
4 on February 14, 2001 and receive a lesser number of regrant options on February 15, 2001 with a \$13.625
5 exercise price. The regrant options vested on August 15, 2001 and expired unless exercised by November
6 15, 2001.

7 23. Under the Regrant Program, Chiang elected to cancel his options on the 50,000 Clarent
8 shares with an exercise price of \$42.875 per share. In exchange for canceling those “underwater” options,
9 Chiang received regrant options on 10,937 Clarent shares with an exercise price of \$13.625. Because
10 Chiang could exercise his regrant options from only August 15, 2001 to November 15, 2001, the Regrant
11 Program provided Chiang with a financial incentive to have Clarent’s stock trade at a high price during
12 that time period by reporting ever increasing revenue.

13 CHIANG’S FRAUDULENT ACTIVITIES

14 *The False Revenue for the Fourth Quarter of the 2000 Fiscal Year*

15 24. Shortly before the end of Clarent’s fourth fiscal quarter in December 2000, Chiang and
16 Chang met for dinner with a representative of D-Link Corporation (“D-Link”), a high technology firm
17 based in Taiwan. At the meeting, Chiang and Chang promised D-Link that if it purchased Clarent
18 software, they would have Articula buy that software from D-Link if it could not find its own customer.
19 Chiang and Chang provided D-Link with four purchase orders for Clarent software at the dinner meeting.
20 A day or so later, an officer of D-Link signed the purchase orders for the Clarent software. Those
21 purchase orders totaled \$7.2 million, and were signed on the last business day of the year, December 29,
22 2000. Without Chiang’s and Chang’s promise to have Articula purchase any unsold software, D-Link
23 would not have purchased the product because D-Link would have risked paying for product that it did
24 not need.

25 25. Clarent shipped the software to D-Link on December 30, 2000. After D-Link failed to
26 find a customer for the Clarent software, Articula issued purchase orders for the unsold product on March
27 30, 2001. Soon after receiving Articula’s purchase orders, D-Link paid Clarent for the unsold product.
28 Later, at the end of June 2001, Articula paid D-Link for the unsold Clarent product. Just before making

1 that payment, Articula received \$25 million from Clarent's Asia Pacific Office at the direction of Chiang
2 and Chang. Articula therefore used Clarent funds to pay D-Link for the unused Clarent product.

3 26. Articula did not, in fact, have any business need for the Clarent product that it supposedly
4 purchased from D-Link. Chiang refused to provide D-Link with instructions for shipping the product to
5 Articula. D-Link attempted to ship via messenger to Articula the software product purchased from
6 Clarent, but the shipment was returned to D-Link.

7 27. Neither Chiang nor Chang informed Clarent's finance or sales order administration
8 department about their oral promises to D-Link or of Articula's subsequent "purchases" from D-Link.
9 As a result of his improper conduct, Chiang improperly induced Clarent to recognize revenue on the \$7.2
10 million in software orders from D-Link. Clarent subsequently included that revenue in its Form 10-K
11 annual report for the period ended December 31, 2000. By including that \$7.2 million in revenue, Clarent
12 materially overstated its fourth quarter revenue by about 15%.

13 ***The False Revenue in the Quarter Ended March 31, 2001***

14 ***The Contingent \$6.1 Million D-Link Transaction***

15 28. At the end of March 2001, Chiang asked D-Link to buy another \$6.1 million of software.
16 D-Link told Chiang that D-Link still had Clarent product on-hand and did not want any additional risk
17 from the purchase of additional product. D-Link would issue a purchase order only if Clarent agreed to
18 give D-Link the right to return the product if D-Link could not resell the product to another customer.
19 Chiang agreed to giving D-Link the right to return the Clarent product.

20 29. D-Link's right of return was set forth in a separate purchase agreement, which provided
21 that "the Buyer may, with a prior notice and in addition to its other rights and remedies, exercise its
22 discretion to immediately return such software, either in part or in full, within 210 days of delivery."

23 30. Chiang did not disclose the right of return to accountants and others in Clarent's finance
24 or sales order departments. To conceal the contingent sales arrangement, Chiang withheld the agreement
25 and other information about the transaction from Clarent's sales order administration and finance
26 departments in Redwood City, California. By letter dated September 14, 2001, D-Link exercised the
27 return right contained in the purchase agreement.

28 31. Chiang's agreement made the purchase order from D-Link a contingent sale that could not

1 be recorded as revenue for that quarter. Clarent retained the risks of ownership until the 210 day return
2 period lapsed. As a result, Chiang improperly induced Clarent to recognize \$5.7 million in revenue on
3 the D-Link transaction for the quarter ended March 31, 2001.

4 ***The Contingent \$6 Million Cradle Transaction***

5 32. Chiang submitted a \$6 million purchase order to Clarent's accounting department on or
6 about March 29, 2001, from a Taiwanese company called Cradle Technologies ("Cradle"). When he
7 submitted the order, Chiang knew that the "sale" to Cradle was phony because Cradle had told him that
8 it only desired about \$500,000 in Clarent product. Chiang therefore told Cradle during the contract
9 negotiations that Cradle could cancel its order. Chiang also signed a letter, dated March 15, 2001, to
10 Cradle giving that customer until February 28, 2002 to return the product or cancel its order.

11 33. Chiang's letter made the \$6 million purchase order from Cradle a contingent sale that
12 could not be recorded as revenue. To conceal the contingent sales arrangement, Chiang withheld the
13 letter and other information about the transaction from Clarent's sales order administration and
14 accounting departments in Redwood City, California. As a result, Chiang improperly induced Clarent
15 to recognize revenue on the \$6 million purchase order from Cradle. Clarent subsequently included that
16 revenue and the D-Link revenue in its Form 10-Q filed for the quarter ended March 31, 2001.

17 ***The False Revenue in the Quarter Ended June 30, 2001***

18 34. Chiang continued his fraudulent scheme during the fiscal quarter ended June 30, 2001 by
19 authorizing another three phony sales contracts totaling nearly \$19 million. Those contracts were with
20 three Asia Pacific Region customers – Cradle, Landsat Communications Pte Ltd. ("Landsat") and
21 Mitracomm Ekasara ("Mitracomm").

22 ***The Contingent \$8 Million Transaction with Cradle***

23 35. In late June 2001, Chiang sought another large purchase order from Cradle. Because it
24 was still carrying unsold Clarent product from its prior purchase order, Cradle did not want to place an
25 additional order. To induce Cradle to issue another purchase order, Chiang signed a letter, dated June
26 25, 2001, granting Cradle the right to alter or cancel its order. Shortly afterwards, on June 29, 2001,
27 Cradle issued software purchase orders totaling \$8 million. Chiang did not disclose the letter or its terms
28 to Clarent's sales order administration or finance departments.

1 36. Because he gave Cradle the right to alter or cancel its orders, Chiang knew that the \$8
2 million “sale” to Cradle could not be recognized as revenue. By concealing the June 25, 2001 letter from
3 Clarent's sales order administration and finance departments, Chiang fraudulently induced Clarent to
4 recognize revenue on the \$7.7 million Cradle transaction. That in turn caused Clarent to include \$8
5 million in phony revenue in its Form 10-Q filing and earnings press release for the quarter ended June
6 30, 2001.

7 ***The Contingent \$5.73 Million Transaction with Landsat***

8 37. Near the end of the June 2001 quarter, Chiang told the head of Clarent's South Asia Sales
9 Division that the quarter was not going well and that the Division needed to obtain another \$5 to \$10
10 million in purchase orders. Chiang also said that such deals could include the following contingent
11 terms: (1) no down payment by the customer; (2) the customer could cancel the deal within 90 days; and
12 (3) no product would actually be shipped to the customer.

13 38. Chiang and the head of Clarent's South Asia Sales Division then asked Landsat, a
14 Singapore company, to place a large order before the end of the quarter. Because it did not need the
15 product, Landsat did not want to incur the risk of issuing a purchase order. Chiang told Landsat that he
16 needed a purchase order to fill his quota for the quarter. Chiang also told Landsat that it could cancel the
17 order in July 2001. Chiang did not disclose this arrangement to Clarent's sales order administration or
18 finance departments.

19 39. On June 29, 2001, an employee at Clarent’s Asia Pacific Region faxed a Sales and
20 Purchase Order form to Landsat. Because Landsat did not know what products to include in the purchase
21 order, Chiang and another Clarent employee determined what products Landsat would purchase. The
22 next day, Landsat faxed a purchase order to Clarent for \$5.73 million in software that had been specified
23 by Chiang.

24 40. Because the purchase order was contingent upon Landsat’s right of cancellation, Chiang
25 knew that Clarent could not recognize revenue on its transaction with Landsat. Chiang also knew that
26 concealing Landsat’s cancellation right from Clarent's sales order administration and/or finance
27 departments would induce the company to recognize revenue improperly on Clarent's books and records.

1 Chiang further knew that such revenue would be improperly reported by Clarent in its earning
2 announcements and reports filed with the Commission.

3 41. Subsequently, in July 2001 Clarent shipped approximately \$5 million in product to
4 Landsat. Landsat's principal was upset about receiving that shipment because Chiang and the head of
5 Clarent's South Asia Sales Division had told him that Landsat could cancel the order and that no product
6 would be shipped. When Chiang learned of Landsat's concern, he authorized Landsat's reshipment of
7 the product to Hong Kong for storage. Chiang also told Landsat's principal that Articula would purchase
8 the Clarent product from Landsat.

9 42. In September 2001, Articula sent to Landsat a purchase order, backdated to June 25, 2001
10 by Articula, for the Clarent software sent to Landsat. That backdated purchase order represented the
11 resale by Landsat of the undesired Clarent shipment. At the same time, however, Articula sent to Landsat
12 a cancellation notice, dated September 13, 2001, of its June 25th purchase order. Because these
13 documents nullified the transfer of any product, Landsat was not making an actual sale of the Clarent
14 product to Articula. This led Landsat to demand the actual cancellation of its order with Clarent.
15 Eventually, in a letter dated October 4, 2001, the head of Clarent's South Asia Sales Division accepted
16 Landsat's cancellation of the order. Through these various shipments and off-setting purchase orders,
17 Chiang was attempting to conceal from Clarent's headquarters his agreement to allow Landsat to cancel
18 its order at any time and to refuse to allow shipment of the Clarent product.

19 43. Later, in December 2002, when the Commission and the United States Attorney were
20 conducting their investigation, Chiang tried to convince Landsat's principal to lie about the circumstances
21 of Landsat's order and cancellation. In particular, Chiang asked Landsat's principal to say falsely that
22 Landsat had returned the product because it was defective, rather than pursuant to the oral right of
23 cancellation.

24 ***The Contingent \$5.3 Million Transaction with Mitracomm***

25 44. The head of Clarent's South Asia Sales Division asked another customer, Mitracomm, to
26 place a multi-million dollar software order before the end of the June 2001 quarter to help Chiang meet
27 his sales quota. The head of sales proposed that Mitracomm buy the product from Clarent before June
28

1 30, 2001, and then subsequently resell the product to the intended user, O'Connor's Singapore Pte Ltd.
2 ("O'Connor's"), which was working on a project in Vietnam.

3 45. Mitracomm was concerned about the size of the order and wanted some assurance that
4 it could cancel the order. Chiang then authorized the head of Clarent's South Asia Sales Division to
5 promise Mitracomm that it could, among other things, cancel the order within 90 days. Chiang did not
6 disclose this arrangement to Clarent's sales order administration or finance department in Redwood City.
7 On June 29, 2001, Mitracomm faxed a purchase order for \$5.3 million to Clarent.

8 46. Because the transaction was contingent on Mitracomm's cancellation rights, Chiang knew
9 that Clarent could not recognize revenue on the purchase order. Chiang also knew that concealing the
10 cancellation right from Clarent's sales order administration and finance departments would cause Clarent
11 to recognize revenue improperly on the Mitracomm transaction and to include such revenue in its
12 earnings announcements and Form 10-Q filing for the quarter ended June 30, 2001.

13 47. Afterwards, Articula had discussions with Mitracomm about purchasing the unsold
14 Clarent product. Mitracomm decided, however, to cancel its order with Clarent. By letter dated October
15 4, 2001, the head of Clarent's South Asia Sales Division confirmed that Mitracomm had cancelled its \$5.3
16 million order and replaced it with a \$304,270 order – *i.e.*, the amount that Mitracomm really needed for
17 the project in Vietnam.

18 48. Subsequently, on October 27, 2001, Mitracomm sent a letter to Ernst & Young, Clarent's
19 outside audit firm, stating that Chiang had asked Mitracomm to issue the purchase order for a project
20 "somewhere in Vietnam, where the deal, so called, will be financed by Articula." The letter also stated
21 that if Articula could not issue a purchase order and pay Mitracomm, Mitracomm could cancel its order
22 with Clarent. Mitracomm stated that it issued the purchase order because of Chiang's position at Clarent
23 and "without realizing that the thing has gone too far." Mitracomm also stated that it believed the product
24 from the order "was stored in Clarent's/Articula's warehouse in Hong Kong."

25 49. Mitracomm's letter to Ernst & Young led to an internal Clarent investigation into whether
26 revenue had been properly recognized in Chiang's region. When interviewed during Clarent's internal
27 investigation, Chiang admitted that he told Clarent's salespeople that they could grant rights of return on
28

1 deals such as Mitracomm and Landsat. The cancellation right was confirmed in a letter, dated October
2 4, 2001, signed by the head of Clarent's South Asia Sales Division.

3 ***The Improper Transfer of \$25 Million to Artacula in Late June 2001***

4 50. In May and June 2001, Chang and Chiang requested that Clarent send \$35 million from
5 its headquarters in Redwood City, California to the Asia Pacific Region. Chang falsely represented to
6 Clarent officials that he wanted the Asia Pacific Region to have its own working capital and to be a
7 separate profit-and-loss entity so that it could eventually be listed on the Hong Kong or Taiwan Stock
8 Exchange. Chang also represented that unless the money was transferred to the Asia Pacific Region by
9 the end of June 2001, Clarent would fail to close large transactions for the June 2001 quarter. Similarly,
10 Chiang falsely represented that the money was needed to run the Asian operations and for a possible stock
11 offering by the Asia Pacific Region.

12 51. The board agreed to transfer the funds, but imposed additional internal controls to ensure
13 headquarters' oversight over the use of the funds. Such controls were needed because in June 2001,
14 Clarent's Chief Financial Officer and in-house legal counsel had determined that Clarent's Asia Pacific
15 Office had previously disbursed funds for supposed consulting services to Artacula without obtaining any
16 written formal agreement for those services. Clarent's Chief Financial Officer had therefore warned
17 Chang and Chiang in June 2001 that such undocumented payments were improper and that the money
18 should be recovered. Clarent's board of directors specified additional internal controls in the Financial
19 Control Procedures Agreement. Chang, Chiang, Clarent's Chief Financial Officer and the Controller of
20 the Asia Pacific Office signed the Financial Control Procedures Agreement on June 22, 2001. The new
21 procedures stated that approval by the Vice President of Finance at Clarent's headquarters was required
22 for transfers between \$1 million and \$5 million. Clarent's Chief Financial Officer's approval was required
23 for transfers exceeding \$5 million.

24 52. On June 22, 2001, the board approved the new procedures and the transfer of funds from
25 Clarent headquarters to Clarent's Asia Pacific Office, which was located in Taiwan. On June 26, 2001,
26 Clarent headquarters transferred \$35 million to the Clarent Asia Pacific Office's bank accounts.

27 53. Notwithstanding the internal controls procedures imposed by Clarent's board and the
28 warnings by Clarent's Chief Financial Officer that undocumented payments were improper, Chang and

1 Chiang almost immediately disbursed the funds from the Clarent Asia Pacific Office to Artacula without
2 the necessary approval of Clarent's Vice President of Finance or Clarent's Chief Financial Officer. Chang
3 and Chiang also failed to follow the Chief Financial Officer's earlier warning that funds could not be
4 disbursed without documentation establishing the obligation by Artacula to repay the money or the
5 purpose for transferring the money. Of the \$35 million that it received on June 26, 2001, the Clarent Asia
6 Pacific Office promptly transferred \$25 million to Artacula on June 27, 2001 and the remaining \$10
7 million in early July 2001. After receiving \$25 million from Clarent's Asia Pacific Office, Artacula paid
8 \$15 million to D-Link to cover its "purchase" of the product that Clarent "sold" to D-Link.

9 54. During Clarent's internal investigation, Chiang admitted knowing about the transfer of the
10 funds from the Clarent Asia Pacific Office to Artacula. Chiang also stated that he understood his
11 obligations under the Financial Controls Procedure Agreement and knew that he needed approval from
12 Clarent's finance department for any expenditure over \$1 million.

13 55. Because Chiang failed to inform Clarent about the improperly transferred \$25 million
14 from the Clarent Asia Pacific Office's bank accounts to Artacula, Clarent's Form 10-Q quarterly report
15 for the period ended June 30, 2001 falsely included the \$25 million on the balance sheet's presentation
16 of the company's "cash" assets and failed to disclose the related party transaction with Artacula.
17 Additionally, because the \$25 million transfer did not take place in accordance with the Financial Control
18 Procedures Agreement, Clarent had not authorized the transfer and, moreover, did not reach any fixed
19 and determinable agreement on or before June 30, 2001 with Artacula for repayment of the money.
20 Furthermore, at the time of transfer, Artacula did not provide Clarent with any documentation for the use
21 of the \$25 million. Chiang therefore induced Clarent to materially overstate its cash by \$25 million in
22 the Form 10-Q filing and earnings release for the quarter ended June 30, 2001. Chiang also induced
23 Clarent's material overstatement of net assets and income for the June 2001 quarter because the \$15
24 million that went to Artacula and then went to D-Link in late June 2001 should have treated as a disguised
25 customer refund for unused Clarent product, while the remaining \$10 million that went to Artacula in late
26 June 2001 should have be written off as an employee theft loss or some other expense.

1 ***Clarent's Restatement of Revenue for the December 2000, March 2001 and June 2001 Quarters***

2 56. Clarent's internal investigation revealed that revenue had been improperly recognized for
3 the entire fiscal year ended December 31, 2000, as well as for the quarters ended March 31, 2001 and
4 June 30, 2001. Clarent's restatement of the fourth quarter of the fiscal year ended December 31, 2000
5 eliminated all of the D-Link revenue. In its Amended Form 10-K filed on May 8, 2002, Clarent stated:

6 The Company discovered that its revenue had been overstated for certain
7 periods because revenue from sales in the Asia-Pacific region had been
8 recognized in situations where customers had indirectly received
9 Company funds from third parties, by means of arrangements effected
through unauthorized acts of Company employees. These arrangements
were entered into in violation of Company procedures and were not
reported to the appropriate personnel within the Company.

10 Revenue also had been overstated for certain periods because revenue had
11 been recognized from certain sales in the Asia-Pacific region where
12 customers now claim to have return rights or that the Company has
13 repurchase obligations. The Company now believes that certain Company
14 personnel may have entered into agreements with customers in the
Asia-Pacific region purporting to provide such return rights or repurchase
obligations. These agreements were entered into in violation of Company
procedures and were not reported to the appropriate personnel within the
Company.

15 57. In the original Form 10-Q filed by Clarent on May 15, 2001 for the quarter ended March
16 31, 2001, the Company reported total revenue of \$61.2 million and a net loss of \$13.9 million for the
17 quarter. In May 2002, Clarent restated the financial statements included in the Form 10-Q for the quarter
18 ended March 31, 2001. The restatement reduced total revenue to \$21 million. Thus, revenue was
19 overstated by 191%.

20 58. In the original Form 10-Q that Clarent filed on August 14, 2001 for the quarter ended June
21 30, 2001, the Company reported total revenue of \$63.2 million and a net loss of \$41.6 million. In May
22 2002, Clarent restated the financial statements included in the Form 10-Q for the quarter ended June 30,
23 2001. The restatement reduced total revenue by \$45.6 million, down to \$17.6 million. Thus, revenue
24 was overstated by 259%. In addition, Clarent informed investors that the company's internal
25 investigation had discovered that over \$35 million had been transferred from Clarent's Asia Pacific
26 Region at the end of June 2001 without authorization or disclosure:

27 As a result of the investigation, the Company has now determined that
28 \$36.5 million had been transferred prior to the end of the second quarter
of 2001 but not reported to the appropriate Company personnel, resulting

1 in a \$36.5 million overstatement of the cash balance for the quarterly
2 period ended June 30, 2001.

3 59. The restated amounts for the quarters ended March 31, 2001 and June 30, 2001 included
4 the elimination of the revenue recognized for the D-Link, Cradle, Landsat and Mitracomm transactions
5 alleged above. Chiang's devices and schemes for the illegal recognition of revenue therefore led to
6 material misstatements in Clarent's public reports and filings and to a significant injury, or potential
7 injury, to Clarent's investors.

8 60. In December 2002, Clarent voluntarily filed for Chapter 11 bankruptcy. Later, on
9 February 13, 2003, a bankruptcy court approved the sale of substantially all of Clarent's assets to a third
10 party.

11 **FIRST CLAIM FOR RELIEF**

12 **Violations of Section 10(b) of the Exchange Act and Rule 10b-5**

13 61. The Commission realleges and incorporates by reference Paragraphs 1 through 60 above.

14 62. Chiang, directly or indirectly, in connection with the purchase or sale of securities, by the
15 use of means or instrumentalities of interstate commerce, or of the mails, with scienter:

16 (a) employed devices, schemes, or artifices to defraud;

17 (b) made untrue statements of material facts or omitted to state material facts
18 necessary in order to make the statements made, in the light of the circumstances under which they were
19 made, not misleading; and

20 (c) engaged in acts, practices, or courses of business which operated or would operate
21 as a fraud or deceit upon other persons, including purchasers and sellers of securities.

22 63. Chiang violated and, unless restrained and enjoined, will continue to violate Section 10(b)
23 of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5].

24 **SECOND CLAIM FOR RELIEF**

25 **Aiding and Abetting Violations of Section 10(b) of the Exchange Act and Rule 10b-5**

26 64. The Commission realleges and incorporates by reference Paragraphs 1 through 60 above.

27 65. Clarent, directly or indirectly, in connection with the purchase or sale of securities, by the
28 use of means or instrumentalities of interstate commerce, or of the mails, with scienter:

(a) employed devices, schemes, or artifices to defraud;

1 (b) made untrue statements of material facts or omitted to state material facts
2 necessary in order to make the statements made, in the light of the circumstances under which they were
3 made, not misleading; and

4 (c) engaged in acts, practices, or courses of business which operated or would operate
5 as a fraud or deceit upon other persons, including purchasers and sellers of securities.

6 66. Chiang knowingly provided substantial assistance to Clarent's violations of Section 10(b)
7 of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5], in violation of Section
8 20(e) of the Exchange Act [15 U.S.C. § 78t(e)].

9 67. Chiang aided and abetted, and unless enjoined will continue to violate and to aid and abet,
10 violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. §
11 240.10b-5].

12 **THIRD CLAIM FOR RELIEF**

13 **Violations of Section 13(b)(5) of the Exchange Act and Rules 13b2-1 and 13b2-2**

14 68. The Commission realleges and incorporates by reference Paragraphs 1 through 60 above.

15 69. Chiang knowingly circumvented Clarent's system of internal accounting controls and
16 knowingly falsified or caused to be falsified Clarent's books, records and accounts within the meaning
17 of Section 13(b)(2)(A) of the Exchange Act [15 U.S.C. § 78m(b)(2)(A)].

18 70. Chiang violated and, unless restrained and enjoined, will continue to violate Section
19 13(b)(5) of the Exchange Act [15 U.S.C. § 78m(b)(5)] and Rules 13b2-1 and 13b2-2 [17 C.F.R. §§
20 240.13b2-1, 240.13b2-2].

21 **FOURTH CLAIM FOR RELIEF**

22 **Aiding and Abetting Violations of Section 13(a) of the Exchange Act**

23 **and Rules 12b-20, 13a-1 and 13a-13**

24 71. The Commission realleges and incorporates by reference Paragraphs 1 through 60 above.

25 72. Clarent filed with the Commission an annual report for the year ended December 31, 2000
26 and quarterly reports on Form 10-Q for the quarters ended March 31, 2001 and June 30, 2001 that
27 contained untrue statements of material fact and omitted to state material information required to be
28 stated therein or necessary in order to make the required statements made, in the light of the

1 circumstances under which they were made, not misleading, in violation of Section 13(a) of the Exchange
2 Act [15 U.S.C. § 78m(a)] and Rules 12b-20, 13a-1 and 13a-13 thereunder [17 C.F.R. §§ 240.12b-20,
3 240.13a-1, 240.13a-13].

4 73. Chiang knowingly provided substantial assistance to Clarent's violation of Section 13(a)
5 of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 12b-20, 13a-1 and 13a-13 thereunder [17 C.F.R.
6 §§ 240.12b-20, 240.13a-1, 240.13a-13], in violation of Section 20(e) of the Exchange Act [15 U.S.C. §
7 78t(e)].

8 74. Chiang aided and abetted, and unless enjoined will continue to aid and abet, violations of
9 Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 12b-20, 13a-1 13a-13 thereunder [17
10 C.F.R. §§ 240.12b-20, 240.13a-1 240.13a-13].

11 **FIFTH CLAIM FOR RELIEF**

12 **Aiding and Abetting Violations of Section 13b(2)(A) of the Exchange Act**

13 75. The Commission realleges and incorporates by reference Paragraphs 1 through 60 above.

14 76. Clarent failed to make and keep books, records, and accounts which, in reasonable detail,
15 accurately and fairly reflected the transactions and dispositions of the assets of the company, in violation
16 of Section 13(b)(2)(A) of the Exchange Act [15 U.S.C. § 78m(b)(2)(A)].

17 77. Chiang knowingly provided substantial assistance to Clarent's violation of Section
18 13(b)(2)(A) of the Exchange Act [15 U.S.C. § 78m(b)(2)(A)], in violation of Section 20(e) of the
19 Exchange Act [15 U.S.C. § 78t(e)].

20 78. Chiang aided and abetted, and unless enjoined will continue to aid and abet, violations of
21 Section 13(b)(2)(A) of the Exchange Act [15 U.S.C. § 78m(b)(2)(A)].

22 **PRAYER FOR RELIEF**

23 WHEREFORE, the Commission respectfully requests that this Court:

24 I. Permanently enjoin defendant Chiang from violating, directly or indirectly, Sections 10(b),
25 13(a), 13(b)(2)(A) and 13(b)(5) of the Exchange Act, and Rules 10b-5, 12b-20, 13a-1, 13a-13, 13b2-1
26 and 13b2-2 thereunder.

27 II. Order defendant Chiang to disgorge all ill-gotten gains received from his illegal conduct,
28 including prejudgment interest.

1 III. Order defendant Chiang to pay civil penalties pursuant to Section 21(d) of the Exchange
2 Act. [15 U.S.C. § 78u].

3 IV. Prohibit Chiang from acting as an officer or director of any issuer that has a class of
4 securities described in Section 21(d)(2) of the Exchange Act [15 U.S.C. § 78u(d)(2)].

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

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

10 DATED: September 30, 2004

11 Helane L. Morrison
12 John S. Yun
13 Kathleen K. Bisaccia
14 Victor W. Hong

15 By: _____
16 John S. Yun

17 Attorneys for the Plaintiff
18 SECURITIES AND EXCHANGE COMMISSION
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DEMAND FOR JURY TRIAL

Plaintiff Securities and Exchange Commission requests a trial by jury.

DATED: September 30, 2004

Helane L. Morrison
John S. Yun
Kathleen K. Bisaccia
Victor W. Hong

By: _____
John S. Yun

Attorneys for the Plaintiff
SECURITIES AND EXCHANGE COMMISSION

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