Dating Game

Stock-Options Criminal Charge: Slush Fund and Fake Employees

U.S. Accuses 3 Ex-Executives At Comverse Technology Of Long-Running Scheme

Scrambling to Avoid Detection

By Charles Forelle
And James Bandler

Kobi Alexander's stellar business career began to unravel in early March with a call from a reporter asking why his stock options had often been granted at the bottom of sharp dips in the stock price of the telecom company he headed, Comverse Technology Inc.

According to an affidavit by a Federal Bureau of Investigation agent, unsealed in Brooklyn, N.Y., the call to a Comverse director set off a furious chain of events inside the company that culminated yesterday in criminal charges against Mr. Alexander and two other former executives. Federal authorities alleged the trio were key players in a decade-long fraudulent scheme to manipulate the company's stock options to enrich themselves and other employees.

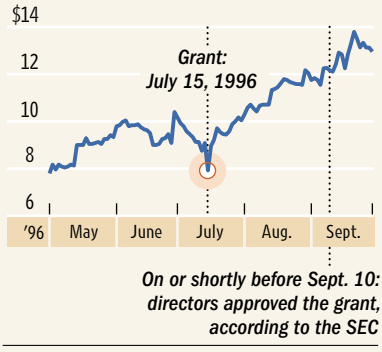
After the March 3 phone call from a Wall Street Journal reporter, the FBI affidavit said, Mr. Alexander and the other two executives, former chief financial officer David Kreinberg and former senior general counsel William F. Sorin, attempted to hide the scheme. Their actions allegedly included lying to a company lawyer, misleading auditors and attempting to alter computer records to hide a secret options-related slush fund, originally nicknamed "I.M. Fanton." It wasn't until a dramatic series of confessions later in March, the affidavit said, that the executives admitted having backdated options. The trio resigned in May.

The criminal and civil charges leveled against the former executives mark an escalation in the widening federal investigation into whether some companies doctored stock options to benefit insiders. More than 80 companies are being investigated so far. The Comverse case is the first in which authorities allege that top executives personally benefited. The three former executives personally gained a total of more than $8 million from the backdating scheme, the FBI affidavit estimated.

The 50-page affidavit and a related civil complaint filed by the Securities and Exchange Commission offer an unusually detailed account of how a blatant backdating scheme allegedly went on for years in the top ranks of a large corporation. The SEC alleged that Mr. Alexander looked back at Comverse's past stock trading and cherry-picked dates for the options grants when the price was low, making the options more valuable. Mr. Sorin then allegedly misled members of the board compensation committee by getting them to sign paperwork with the prior grant dates already filled out, the government charged.

Impeccable Timing

One of numerous grants at Comverse Technology the U.S. says were backdated to low-price days:



Note: Stock prices adjusted for splits.

Sources: FactSet Research Systems via WSJ Market Data Group; federal court filings

Stock options, which have become the primary form of compensation for many top executives, give recipients the right to buy the company's stock at a certain exercise or "strike" price. They typically are set at the stock's fair-market value at the time of the grant, giving recipients an incentive to make the stock rise and profiting them only if it does. Manipulating grants to give a lower strike price effectively hands recipients potential for additional profit. It also can cause a raft of accounting and tax problems, not to mention criminal or civil liability for those responsible.

Officials from the Justice Department, SEC and FBI announced the charges in Washington. "When options are backdated to a time when the share price was lower, and without honest disclosure, those options are simply theft from shareholders," said Deputy Attorney General Paul McNulty.

Messrs. Kreinberg and Sorin surrendered to FBI agents yesterday morning and appeared before a federal magistrate in Brooklyn in the afternoon. They entered no pleas, and bond was set at $1 million each. Lawyers for the two men declined to comment after the hearing.

Mr. Alexander's whereabouts weren't clear, and a warrant has been issued for his arrest. Justice Department officials declined to say whether they knew where Mr. Alexander was or whether he was considered a fugitive. An attorney for Mr. Alexander, Keith Krakaur, declined to comment on the federal charges.

The SEC alleged that the backdating scheme led Comverse to overstate its profits from 1991 through 2005. The company has admitted to accounting problems and said it will restate financial results. In a statement yesterday, Comverse said it had cooperated fully with federal authorities

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Comverse Executives Face Stock-Options Charges

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and would continue to do so.

Officials said Comverse provided the government with information obtained during internal investigations, and that they expected those charged would challenge the admissibility of statements made to company lawyers.

Mr. Alexander is a dual citizen of the U.S. and Israel. Prosecutors moved to seize more than $45 million in assets held in accounts at a New York financial institution after they alleged he recently wired $57 million to Israel. Prosecutors in court papers alleged that the transfers were "designed to conceal the tainted funds from U.S. authorities."

According to the SEC, the backdating scheme stretched back to 1991, when Comverse was a scrappy player challenging much larger rivals in the telecommunications industry.

The company had its roots more than a decade earlier, when Mr. Alexander, son of the head of Israel's national oil company, moved to the U.S. after studying economics. In the late 1970s, he worked as an investment banker while earning a business degree at night.

He and an Israeli engineer hatched the idea of starting a voice-mail technology company, according to a 1990 article about Mr. Alexander in Newsday. Based in New York, Comverse eventually became a world leader in the field, making software and hardware systems behind the voice-mail services for corporate, government and wireless phone networks. It now has more than 5,000 employees and about $1.2 billion in annual revenue.

Some say the company reflects the exacting personality of Mr. Alexander, who served in an elite unit in the Israeli army. "He's a tough guy, a tough person. The company took on his toughness," said Mark McIlvane, a former Comverse marketing executive. He added that Mr. Alexander kept a tight rein on costs during the early days of the company, even objecting if employees rented too large a car.

A finance and strategy specialist, Mr. Alexander, 54 years old, was able to propel Comverse ahead by securing important contracts with "Baby Bells" and overseas phone companies. In 1997, Comverse, then big in Europe, expanded in the U.S. by buying a competitor. Comverse became a family affair for the Alexanders, with Mr. Alexander's father, sister and brother-in-law, a co-founder, serving at various times on the board.

Mr. Sorin, 56, is one of Mr. Alexander's closest associates. He has been with the company since 1984, having served as a director and corporate secretary. The Harvard Law-educated attorney reviewed and signed the company's annual reports, and also drafted and reviewed its proxy statements and stock-option plans, the government said.

Mr. Kreinberg, 41, who joined in 1994, had been at the company's auditor, Deloitte & Touche LLP. He became chief financial officer in 1999.

As is the practice at many companies, the compensation committee of the board approved stock-option grants at Comverse. Approvals weren't official, according to federal authorities, until the committee members voted on them or signed documents indicating their assent. The SEC said Comverse's option grants came whenever Mr. Alexander chose to set the process in motion. According to federal authorities, he would look over recent trading in the stock and pick a day when the price had dropped, pretending the options had been awarded on that date, which would be more favorable to options recipients. After 1998, Mr. Kreinberg also helped with the date-selection process, the government asserted.

It said Mr. Sorin, who was responsible for interactions with the compensation committee, in effect tricked it. Mr. Sorin first would call committee members to say options-granting paperwork was on its way. He or an assistant would send members written "consent" forms to approve the grants, which bore the selected dates and said the options were to be granted "as of" those dates, the SEC said.

The account said committee members would sign the forms, which didn't contain any place for them to indicate when they signed—the only date on the forms being the earlier date that had been chosen. "This was done to conceal the true date of the grant," the FBI affidavit stated. In some cases, it said, directors didn't sign the forms until weeks or months after the purported grant date.

In the affidavit, FBI special agent Kevin Riordan said two compensation-committee members told him they assumed the "as of" date on the consent forms they later received was the day Mr. Sorin had called them. It was not, the affidavit said, adding: "No corporate action whatsoever occurred on the 'as of' dates." The FBI agent added in his affidavit that the two committee members told him they didn't realize the grant carried a lower trading price and that they "did not intend to grant in-the-money options."

One member of the compensation committee for an extended period was Mr. Alexander's sister, Shaula Yemini. She described a similar practice as the other two committee members, the affidavit said.

All told, the SEC said at least 26 stock-option grants were backdated in this way from 1991 to 2001.

A grant dated July 15, 1996, appears at first blush to be a feat of remarkable timing. That day, Comverse shares closed at $23.75; the grant carried that "exercise price," entitling recipients to potentially profit from any rise above that level. That date is the bottom of an icicle-like dip in Comverse's stock chart; shares jumped 13% the next day and by the end of the year had reached more than $37.

Mr. Alexander received 100,000 options, nearly a quarter of those granted. The SEC said options were distributed "company-wide."

The grant really wasn't made that date, the SEC asserted, but instead, Mr. Alexander picked the date after "looking back at trading history." The agency said directors' consents were likely signed two months later, around Sept. 10, though as usual the signatures weren't dated. The stock closed at $36.50 on Sept. 10, so Mr. Alexander's 100,000 options dated July 15 carried $1.275 million more in potential profit than if they had borne the Sept. 10 price.

As Comverse expanded, so did its option grants. In one dated Oct. 18, 1999, the company gave out 3.8 million options at an exercise price of $93 per share—on a date later selected by Messrs. Alexander and Kreinberg, according to the SEC. The agency said Mr. Sorin didn't send the consent forms to directors until Nov. 23, 1999, by which time the stock price was above $127.

The difference meant $130 million in extra potential profit to the 1,633 grant recipients, the SEC calculated, with the extra potential amount for Mr. Alexander alone at $10.7 million.

A slush fund was formed in 1999, during the frenzied run-up of tech stocks, according to the FBI affidavit. Its purpose, authorities said: to hide extra options that Mr. Alexander could dole out to favored employees, particularly to keep them out of the arms of competitors.

The slush fund was initially called "I.M. Fanton" in the company's computer system, the affidavit said. The name, according to the affidavit, was the brainchild of an unnamed assistant, who dreamed it up after seeing "Phantom of the Opera." The person apparently thought better of the name, the affidavit said, and later changed it to "Fargo," after a Coen Brothers black comedy about bumbling criminals.

The government alleged that Messrs. Alexander and Kreinberg populated the slush fund with options by telling the assistant to create dozens of phony employee names to be mixed in with real people on the list of options presented to directors for approval. The assistant merged first and last names of acquaintances to make the bogus names, the affidavit said. Hundreds of thousands of options were thus approved with no real recipient, the government said.

In 2001, Messrs. Alexander and Kreinberg told the assistant to give 10,000 options apiece to 25 more fake employees, the affidavit said. The board unknowingly approved these, too.

In August 2000, Messrs. Alexander and Kreinberg directed the transfer of 48,000 slush-fund options to an Israeli executive displeased with his pay, the affidavit said, adding that Mr. Alexander also directed that the "vesting period" of the options be changed so the executive could cash them out immediately. The executive did, making an instant $2 million, the affidavit said.

In doing its 2001 audit, Deloitte asked for documentation related to stock-option grants. According to the SEC, Mr. Kreinberg instructed an assistant to give the auditors a computer printout of grants but remove a page relating to the Fargo slush-fund options.

On the first Sunday in March, Messrs. Alexander, Kreinberg and Sorin gathered with another company lawyer at Comverse's offices to discuss the Wall Street Journal inquiry, the government said. The Journal's call in early March was occasioned by a remarkable pattern in the eight grants to Mr. Alexander between 1994 and 2001. All but one were dated just before a sharp run-up in company shares; the Journal's analysis figured that the odds of the grant dates falling as they did purely by chance was around one in six billion.

According to the FBI affidavit, Mr. Alexander denied to the company lawyer that there'd been backdating, stating that he had noticed a dip in the stock price and decided that very day to grant the options. Messrs. Alexander, Kreinberg and Sorin stuck with that account for several days.

After meeting with their own lawyers, the three began to backtrack, the government said. In a later meeting with an in-house lawyer, the trio said there might be "some issues" because "hypothetically speaking," phone calls to the compensation committee weren't made on the dates of the grant, according to the affidavit. It added that Messrs. Alexander and Kreinberg "importuned" the in-house lawyer "to handle the internal investigation personally instead of hiring independent counsel." The next day, Comverse's board formed a special committee to investigate the matter.

Around the same time, according to the FBI, Mr. Kreinberg told a Deloitte partner the company's options grants were legal and blamed any discrepancies on a prior chief financial officer. The FBI affidavit called the statements "lies." Mr. Alexander later defended the backdating on the ground that everyone in high technology was "doing it" and Comverse stock was going crazy, the affidavit said.

As company lawyers in March continued to press Messrs. Alexander and Kreinberg about the options' unusual timing, Mr. Kreinberg apparently realized the slush-fund options might be a problem, the affidavit said. Around March 10, the same day the board committee was formed, he used an assistant's password to change the date when the phantom account had been closed. He changed it to a day in 2002 when lots of activity occurred, so that investigators would be less likely to detect it, the affidavit said.

But Mr. Kreinberg apparently realized that his actions would leave a computer trail, the affidavit continued, and tried to reverse the change. Calling himself an "idiot," he asked an assistant to make a minor change to every account record, to cover up his tampering, the FBI affidavit stated.

Comverse's stock traded at $19.37 on the Nasdaq market yesterday, down 15 cents on the day but off about 35% since the options problem surfaced in March. The shares had reached a stock-split-adjusted price of more than $121 in early 2001.

—Ben Winograd and Chad Bray contributed to this article.

A Scramble at Comverse

Recent events at Comverse, based on the affidavit sworn by Kevin Riordan, an FBI special agent.

March 3, 2006: WSJ reporter calls chairman of Comverse's compensation committee about suspicious pattern of options grants. CEO Kobi Alexander responds "we picked good days."

March 5: Mr. Alexander, finance chief David Kreinberg and General Counsel William Sorin meet with company lawyer.They explain the unusual pattern by saying that Mr. Alexander had "noticed a dip in the stock price and picked that date, the same day, for an options grant."

March 9: Messrs. Alexander, Sorin and Kreinberg tell Comverse lawyer there may be "issues" and "hypothetically speaking" they may not have called compensation committee members for approval on the date of the grants and that they may have "looked back" in selecting options dates.

March 10: Board forms special committee to investigate the options dating. Mr. Kreinberg tampers with internal software that tracked options grants, then changes his mind and reverses the alterations.

March 13: Mr. Alexander and Mr. Kreinberg admit to Comverse lawyer that grants were backdated and there were grants to fictitious individuals.

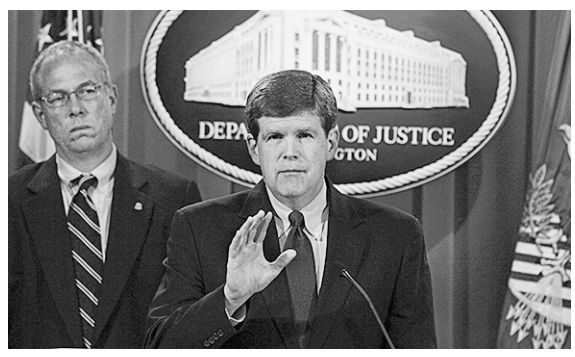
March 14: Comverse stock drops 15% after company announces it has launched internal investigation to review options grants

March 18: WSJ publishes its "Perfect Payday" article, which looks at options grants at Comverse and other companies. It puts the odds of the grants at Comverse happening by chance at 1 in six billion.

April 17: Comverse admits backdating grants, says it expects to restate more than five years of results.

May 1: Messrs. Alexander, Kreinberg and Sorin resign.

Aug. 9: Messrs. Alexander, Kreinberg, Sorin charged with conspiracy to backdate options.



AP

Deputy Attorney General Paul McNulty *announces charges against former Comverse executives.*

Korea's Central Bank Raises Interest Rate

SEOUL, South Korea—Despite recent data showing the country's economy slowing, the Bank of Korea Thursday increased its key interest rate by a quarter percentage point to 4.5%, a five-year high.

The move surprised the markets, because expectations had been tilted toward a rate freeze as the country's economy showed moderating growth with inflation remaining under control. The nation's Kospi stock index was down 0.6% at midday.

However, a majority of economists polled recently by Dow Jones Newswires thought the central bank would stay biased toward further tightening because inflation was likely to edge up in coming months.

Moreoever, following its July monetary-policy meeting, the central bank warned of "persistent inflationary pressures due to the economic recovery and high oil prices," suggesting possible future increases.

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