



U.S. Securities and Exchange Commission

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

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Accounting and Auditing Enforcement Release No. 1282

SECURITIES AND EXCHANGE COMMISSION v. HYBRID NETWORKS, INC., CARL S. LEDBETTER, GUSTAVO EZCURRA, AND CRAIG STEIN, United States District Court for the Northern District of California, San Jose Division, Civil Action No.: C-00-20718-PVT

S.E.C. CHARGES SILICON VALLEY COMPANY AND FORMER EXECUTIVES WITH FALSELY INFLATING REVENUE FOR 1997 IPO

The United States Securities and Exchange Commission ("Commission") today sued Hybrid Networks, Inc. ("Hybrid" or the "Company"), a San Jose-based manufacturer of cable and wireless Internet access systems, for issuing false financial statements in connection with its November 1997 initial public offering and for the first quarter following the IPO. The Commission also charged former Vice President of Sales Gustavo Ezcurra and former Regional Sales Director Craig Stein with fraud in connection with the issuance of the false financial statements. In addition, the Commission charged former President and Chief Executive Officer Carl S. Ledbetter with failing to implement internal accounting controls reasonably sufficient to prevent the fraud. In a related administrative proceeding, the Commission charged Ronald G. Davies, a former executive for one of Hybrid customers, with being a cause of the fraud.

Simultaneous with the filing of the Commission's lawsuit, Hybrid and each of the individual defendants consented, without admitting or denying the allegations in the complaint, to the issuance of injunctions against future violations of the federal securities laws. In addition, Ledbetter, Ezcurra and Stein agreed to pay civil penalties of \$50,000 each. Davies also consented, without admitting or denying the findings in the Commission's administrative order, to cease and desist from future violations of the federal securities laws.

The Commission alleges that Hybrid falsely inflated its 1997 revenue and income through a series of improper and fraudulent transactions. Hybrid subsequently restated its financial results for the period, reducing 1997 revenue from \$14.3 million to \$4.1 million (representing a 249% overstatement of revenue) and increasing net loss from \$13.6 million to \$21.6 million (representing a 37% understatement of net loss). The Company's rapidly deteriorating financial situation led to a decline in Hybrid's stock price from a post-IPO high of \$24 to approximately \$2 before NASDAQ delisted the Company in December 1998.

The Commission's complaint alleges that Hybrid boosted its revenue and income by improperly recording revenue on shipments that customers had a right to return, on shipments "parked" with third parties until the intended customer was prepared to make the purchase, and on shipments of products which customers had not ordered or which did not function

properly. For example, at the end of 1997, with Hybrid's revenue forecasts falling far short of analysts' expectations, the Company shipped \$1.8 million in products to a distributor. This sale alone - Hybrid's largest ever - accounted for over a third of the quarter's revenue, and 15% of the revenue for the year. As part of the deal, Regional Sales Director Stein sent the distributor a secret side letter providing an absolute right to return the products, which made it improper for Hybrid to recognize revenue on the transaction. Stein and Vice President of Sales Ezcurra then concealed the side letter from Hybrid's senior management and auditors. CEO Ledbetter, while unaware of the side letter, disregarded other facts that called into question the validity of the sale. Davies, who was then an Executive Vice President at the distributor, misled Hybrid's senior management and auditors by failing to disclose the side letter when he was asked by the Company to confirm the terms of the sale.

Each defendant consented to injunctions against violations of the following provisions:

Hybrid:

Periodic reporting and books and records (Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 12b-20, 13a-1, and 13a-13 thereunder);

Ledbetter:

Periodic reporting, books and records, and internal controls (Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Exchange Act and Rules 12b-20, 13a-1, 13a-13 and 13b2-1 thereunder);

Ezcurra:

Fraud, periodic reporting, books and records, internal controls and representations to auditors (Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-13, 13b2-1 and 13b2-2 thereunder); and

Stein:

Fraud, periodic reporting, books and records and internal controls (Section 17(a) of the Securities Act of 1933, Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-13 and 13b2-1 thereunder).

In the related administrative proceeding, Davies consented to the entry of a Commission order to cease and desist from committing or causing violations of the provisions governing fraud, periodic reporting, internal controls and representations to auditors (Sections 10(b), 13(a), and 13(b)(5) of the Exchange Act and Rules 10b-5, 12b-20, 13a-13, 13b2-1, and 13b2-2 thereunder). In the Matter of Ronald G. Davies, Securities Exchange Act of 1934 Rel. No. 42987, Auditing and Accounting Enforcement Rel. No. 1281, Administrative Proceeding File No. 3-10244 (June 28, 2000).

<http://www.sec.gov/litigation/litreleases/lr16614.htm>