SEC Charges Former CEO, CFO, and Controller of Gateway, Inc. with Fraud

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Gateway Agrees to Issuance of a Cease-and-Desist Order

Washington, D.C., Nov. 13, 2003 — The Securities and Exchange Commission announced today the filing of fraud charges against the former chief executive officer, chief financial officer, and controller of San Diego-based Gateway, Inc., for engaging in a fraudulent earnings manipulation scheme to meet Wall Street analysts' expectations, and for making false statements and concealing from the investing public important information about the success of Gateway's personal computer (PC) business, in the second and third quarters of 2000. The Commission's lawsuit, filed today in federal court in San Diego, seeks antifraud injunctions, civil money penalties, disgorgement of ill-gotten gains, and orders permanently barring the defendants from serving as officers or directors of public companies.

Named in the Commission's complaint are the following defendants.

> Jeffrey Weitzen, age 47, of Rancho Santa Fe, Calif. Weitzen was Gateway's chief executive officer and a member of its board of directors.
>
> John J. Todd, age 43, of Rancho Santa Fe, Calif. Todd was senior vice president and chief financial officer of Gateway.
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> Robert D. Manza, age 42, of Plano, Tex. Manza was Gateway's controller during the relevant time and is a certified public accountant.

In a separate administrative proceeding, Gateway, without admitting or denying the Commission's findings, agreed to entry of a Commission order that it cease and desist from violations of the antifraud, reporting, books and records, and internal controls provisions of the federal securities laws.

The SEC's complaint alleges that defendants misrepresented or failed to disclose (1) significant trends in Gateway's business; (2) that PC sales growth was declining; (3) that, by the end of the third quarter, only a small percentage of net income was associated with PC sales; and (4) that revenue and earnings included various one-time transactions. Through these actions, the defendants gave the false and misleading impression that Gateway, unlike many of its competitors, was outpacing an industry trend of decreasing sales of personal computers.

Stephen M. Cutler, SEC Director of Enforcement, said, "The Commission continues to be absolutely committed to investigating and bringing complex financial fraud actions like this one. A fraud achieved through numerous small accounting tricks, as here, is just as harmful to investors as any other. We will hold accountable individuals who produce deceptive financial results, no matter what means they use."

"This action illustrates the harm that can result when corporate executives measure success by meeting the short-term expectations of Wall Street analysts," said Randall R. Lee, Regional Director of the SEC's Pacific Regional Office. "The former Gateway executives the Commission charges today were preoccupied with meeting analysts' expectations, to the extent that they fraudulently reverse-engineered Gateway's financial results to do so. This action also demonstrates the Commission's resolve to prosecute those executives, including CEOs, who mislead investors about the underlying health and business prospects of their companies."

The Commission's complaint alleges that in approximately May 2000, when defendants realized that the company would not meet the expectations of the Wall Street analysts who followed Gateway's stock, they embarked on a fraudulent scheme to "close the gap" between analysts' expectations and the company's actual revenue and earnings.

According to the complaint, in the second quarter of 2000, the scheme included contacting individuals whose credit applications had previously been denied by the company, and offering them pre-approved financing to facilitate sales. The sales campaign to high-risk customers contributed more than 5% of Gateway's second quarter revenues.

Also according to the complaint, when Todd recognized that he could not close the gap simply by increasing the amount of PC sales to high-risk customers, he allegedly authorized a wider variety of improper accounting actions, all of which failed to comply with generally accepted accounting principles (GAAP). These included (1) reducing loan loss reserves; (2) recognizing revenue from a consignment sale; (3) recognizing revenue from a purported bill-and-hold sale; (4) accelerating purported revenue from payments by America Online, Inc. (AOL) for bundling its internet service with a Gateway PC purchase; (5) recording revenue from the sale of the company's fixed assets; and (6) making additional undisclosed accounting adjustments to meet analysts' earnings estimates.

According to the Commission's allegations, as a result of the improper accounting actions, Gateway announced that, for the third quarter of 2000, it exceeded analysts' expectations for revenue by $30 million, met analysts' expectations for earnings per share (EPS) of $0.46, and experienced year-over-year revenue growth of 16%. According to the complaint, these statements about Gateway's financial performance were false and misleading. The improper actions by defendants caused Gateway's net income for the third quarter of 2000 to be overstated by more than ten cents EPS, or 30%, and inflated reported revenue by $154 million, or 6.5%.

In its complaint, the Commission charged Weitzen, Todd, and Manza with violating the antifraud and false statements to accountants provisions of the federal securities laws. The Commission further charged Todd and Manza with violating record-keeping and internal controls provisions, and aiding and abetting Gateway's violations of the reporting and record-keeping provisions. Finally, the Commission charged Weitzen with violating the antifraud and reporting provisions as a control person of Gateway.

The Commission also today instituted a settled administrative proceeding against Gateway. In its cease-and-desist order, the Commission found that, through the conduct described above, Gateway violated the antifraud, reporting, and record-keeping provisions of the federal securities laws. The Commission also found that Gateway violated the internal controls provision by failing to observe consistent quarter-end cutoff dates and times, which caused it to have accounting periods of different lengths from quarter to quarter. Without admitting or denying the Commission's findings, Gateway consented to the Commission's order to cease and desist from committing or causing any violation or future violation of these provisions.

In its order, the Commission also found that the Company's cooperation was not exemplary during the early stages of the staff's investigation. In determining to accept Gateway's settlement offer, however, the Commission considered Gateway's undertakings to provide further cooperation and recent remedial measures undertaken by Gateway's current management and board of directors.

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See Also: Administrative Proceedings Release No. 33-8338; Litigation Release No. 18454; Complaint: *SEC v. John J. Todd, Robert D. Manza and Jeffrey Weitzen*

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