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9 UNITED STATES DISTRICT COURT

10 NORTHERN DISTRICT OF CALIFORNIA

11 SAN JOSE DIVISION

12 IN RE BLUE COAT SYSTEMS, INC. ) Lead Case No. 5:06-cv-04809-JF  
DERIVATIVE LITIGATION ) (Consolidated with 5:06-cv-05453)

13 )  
14 This Document Relates To: )

15 ALL ACTIONS. )

Judge: Hon. Jeremy Fogel

VERIFIED AMENDED CONSOLIDATED  
SHAREHOLDER DERIVATIVE  
COMPLAINT

16 KERMIT BAKER and CAROLYN ADDUCI, )  
Derivatively on Behalf of BLUE COAT )  
17 SYSTEMS, INC., )

18 Plaintiffs, )

19 vs. )

20 BRIAN M. NESMITH, DAVID A. DE )  
SIMONE, STEPHEN P. MULLANEY, DAVID )  
21 L. COX, JR., CAMERON S. LAUGHLIN, )  
KEVIN S. ROYAL, DAVID W. HANNA, )  
22 JAMES A. BARTH, TIMOTHY A. HOWES, )  
KEITH GEESLIN, MICHAEL A. MALCOM, )  
23 MICHAEL J. JOHNSON, ALAN L. ROBIN, )  
ROBERT VERHEECKE, JOHN M. )  
24 SCHARBER, TOM AYERS, RANGASWAMY )  
VASUDEVAN, WILLIAM S. WARNER, )  
25 SUSAN HOVATTER THORNTON, STUART )  
PHILLIPS, MARC ANDREESSEN, ANDREW )

26 )  
27 )  
28 [caption continued on the following page] )

1 S. RACHLEFF, PHILIP J. KOEN and ERNST )  
2 & YOUNG LLP, )

3 Defendants, )

4 -and- )

5 BLUE COAT SYSTEMS, INC., a Delaware )  
6 corporation, )

7 Nominal Defendant. )

DEMAND FOR JURY TRIAL

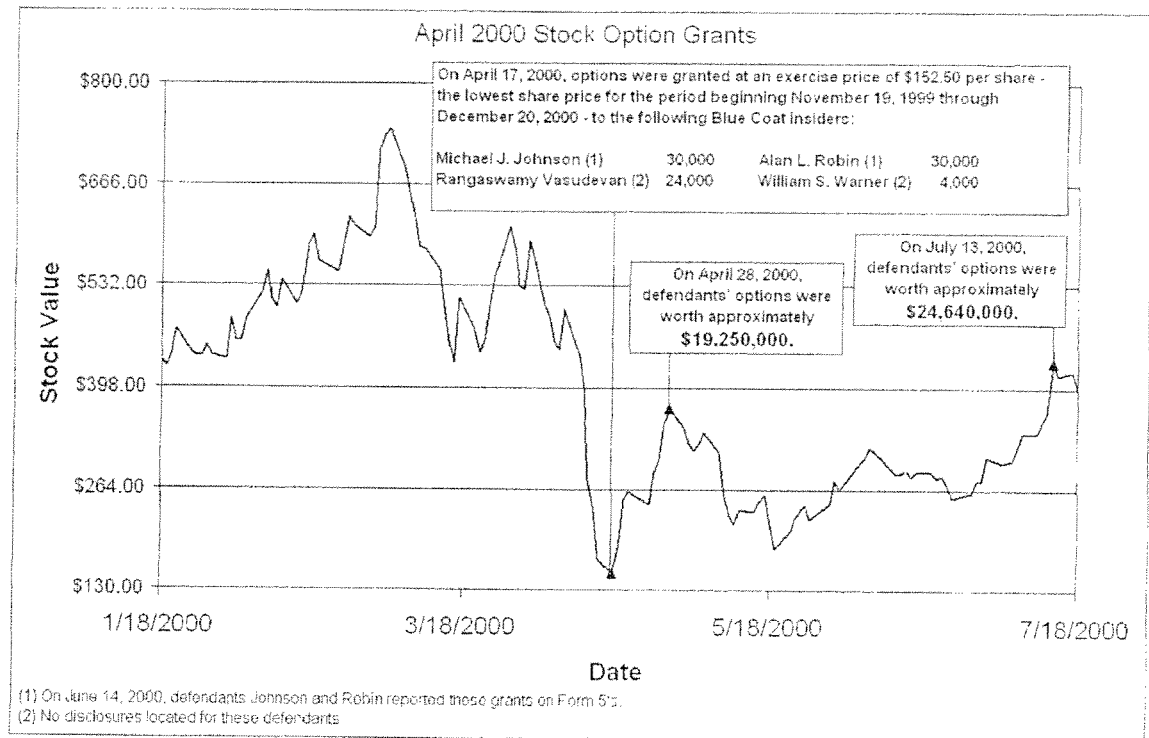
1 Plaintiffs, by their attorneys, submit this Amended Consolidated Shareholder Derivative  
2 Complaint (the "Complaint") against the defendants named herein.

3 **NATURE AND SUMMARY OF THE ACTION**

4 1. This is a consolidated shareholder derivative action brought by two shareholders of  
5 Blue Coat Systems, Inc. ("Blue Coat" or the "Company") on behalf of the Company against certain  
6 of its officers and directors and against the Company's outside auditors, Ernst & Young LLP  
7 ("E&Y"), seeking to remedy defendants' violations of state and federal law, including violations of  
8 the Securities Exchange Act of 1934 ("Exchange Act") and the California Corporations Code,  
9 breaches of fiduciary duties, abuse of control, gross mismanagement, unjust enrichment, professional  
10 negligence and accounting malpractice that have caused substantial losses to Blue Coat and other  
11 damages, such as to its reputation and goodwill. On behalf of Blue Coat, this action seeks, among  
12 other things, damages, corporate governance reforms, an accounting, rescission, restitution and the  
13 declaration of a constructive trust to remedy defendants' violations of state and federal law.

14 2. On April 17, 2000, four Blue Coat senior officers, defendants Michael J. Johnson  
15 ("Johnson"), Rangaswamy Vasudevan ("Vasudevan"), Alan L. Robin ("Robin") and William S.  
16 Warner ("Warner"), received options to buy 88,000 shares. In accordance with Blue Coat's stock  
17 option plans in effect during April 2000, the grants to these defendants were priced at \$152.50 per  
18 share, Blue Coat's stock price on April 17, 2000.

19 3. After the Blue Coat officers received the grants priced at Blue Coat's April 17, 2000  
20 stock price, the Company's share price more than doubled over the following two months.  
21 Specifically, the 88,000 shares underlying options, which were worth nothing at the time they were  
22 granted, grew in value to over **\$19 million** in just two weeks later and then eventually appreciated to  
23 over **\$24 million** after two months. Even more astonishing, these options were priced at Blue Coat's  
24 lowest stock price for the thirteen-month period of November 19, 1999 through December 20, 2000.  
25 These option grants and Blue Coat's stock price movement are illustrated by the following graph:  
26  
27  
28



4. The selection of a date of April 17, 2000 for these options did not involve mere fortuitous timing, however. This grant was part of a grander scheme reaching back to at least 1999, in which certain Blue Coat insiders manipulated stock option grant dates so as to secretly maximize the option recipients' profits. Specifically, certain Blue Coat insiders changed stock option grant dates to take advantage of lower exercise prices than the price of the stock on the actual grant date. The price of Blue Coat shares on the reported option grant date, therefore, was lower than the share price on the actual day options were issued. By engaging in this scheme, Blue Coat insiders enjoyed an instant paper gain and defendants were able to conceal from investors that they were violating shareholder-approved stock option plans, that the Company was not recording material compensation expenses, and that it was materially overstating Blue Coat's net income and earnings per share. This illegal practice has become commonly known as "backdating."

5. Besides backdating, certain of the defendants also engaged in a type of options manipulation known as "springloading." "Springloading" involves the timing of option grants to take advantage of non-public positive material information. Specifically, a springloaded options grant is dated just before a positive news release to create a springload effect whereby the options

1 grant immediately appreciates by a substantial amount as the market absorbs the information. For  
2 example, on May 2, 2005, defendants authorized grants of 75,000 shares underlying options one day  
3 before Blue Coat announced a lucrative contract with the state of Delaware. This "springloaded"  
4 option grant appreciated by over 40% over the following 20 days.

5 6. In short, the April 17, 2000 and May 2, 2005 grants allowed certain of the defendants  
6 to make some very quick and substantial profits at the Company's expense. Indeed, by 2006, these  
7 defendants had acquired millions of dollars worth of manipulated Blue Coat stock options.

8 7. Moreover, as illustrated by backdated grants during September 2003 and August  
9 2004, as alleged below, certain of the defendants remained undeterred by the stringent filing  
10 regulations of the Sarbanes-Oxley Act of 2002 ("SOX"), which required them to disclose their  
11 option grants within two business days of the actual grant date. These defendants did not bother to  
12 disclose their grants for months – sometimes *years* – later.

13 8. During July 2006, Blue Coat announced for the first time that an internal  
14 investigation of the Company's prior options grant practices was being conducted. The Company  
15 later announced that a restatement of its publicly-filed financial statements would be necessary to  
16 correct for previously-hidden stock option compensation expenses that had been incorrectly  
17 accounted for.

18 9. Blue Coat filed its restatement on March 28, 2007, along with limited disclosures of  
19 the findings of its internal investigation. These findings conveyed some very disturbing news.  
20 Apparently, the investigation had determined that "*nearly all*" of Blue Coat's stock options granted  
21 since November 18, 1999 had been manipulated. How did this happen?

22 10. The primary explanation is that Blue Coat's board of directors (the "Board") and  
23 Compensation Committee recklessly authorized options grants. Indeed, on many occasions, the  
24 Board and Compensation Committee did not even meet personally to approve stock option grants.  
25 Rather, the Board and Compensation Committee relied upon easily-manipulated faxed unanimous  
26 written consent forms. Such forms effectively amounted to "blank checks" evidencing an utter lack  
27 of internal controls but reasonably calculated to prevent the detection of the manipulation of stock  
28 option grants.

11. Moreover, the Compensation Committee refused to adequately inform itself as to the implications of stock option misdating before approving options. Thus, the Compensation Committee routinely approved stock option grants weeks after the options grant date. E&Y, as Blue Coat's outside auditor, failed to detect and/or sufficiently question this illicit, pervasive practice at the Company.

12. As a result of the defendants' improprieties, the Company has and will need to expend significant sums of money and has incurred significant damages as alleged herein. Further, Blue Coat's business reputation has been severely damaged by defendants' selfish actions, which portray a Company compromised by a systemic lack of managerial integrity. Accordingly, this action is necessary to end defendants' illegal option-manipulating practices and to restore assets to the Company that have been squandered via the payment of undisclosed and undeserved compensation to corporate insiders.

#### JURISDICTION AND VENUE

13. This Court has jurisdiction over all claims asserted herein pursuant to 28 U.S.C. §1331. Plaintiffs' claims arise in part under the Constitution and laws of the United States, including SOX and the Exchange Act. This Court has supplemental jurisdiction pursuant to 28 U.S.C. §1367(a). This action is not a collusive action designed to confer jurisdiction on a court of the United States that it would not otherwise have.

14. This Court also has jurisdiction over all claims asserted herein pursuant to 28 U.S.C. §1332(a)(2), because complete diversity exists between the plaintiffs and each defendant, and the amount in controversy exceeds \$75,000. This action is not a collusive action designed to confer jurisdiction on a court of the United States that it would not otherwise have. This Court also has supplemental jurisdiction pursuant to 28 U.S.C. §1367(a).

15. Venue is proper in this Court pursuant to 28 U.S.C. §1391(a) because one or more of the defendants either resides in or maintains executive offices in this District, and a substantial portion of the transactions and wrongs that are the subject of this complaint, including the defendants' primary participation in the wrongful acts detailed herein, aiding and abetting, and conspiracy in violation of fiduciary duties owed to Blue Coat, occurred in substantial part in this

District. Finally, defendants have received substantial compensation in this District by doing business here and engaging in numerous activities that had an effect in this District.

### PARTIES

16. Plaintiff Carolyn Adduci ("Adduci") is, and was at times relevant hereto, an owner and holder of Blue Coat stock. Plaintiff Adduci is a citizen of Massachusetts.

17. Plaintiff Kermit Baker ("Baker") is, and was at times relevant hereto, an owner and holder of Blue Coat stock. Plaintiff Baker is a citizen of Florida.

18. Nominal Defendant Blue Coat, formerly known as Cacheflow, Inc., ("Cacheflow") is a Delaware corporation with its principal executive offices located at 650 Almanor Avenue, Sunnyvale, California. According to its public filings, Blue Coat provides proxy appliances related to the visibility and control of internet communications.

19. Defendant Brian M. NeSmith ("NeSmith") is Blue Coat's President, Chief Executive Officer ("CEO") and a director and has been since March 1999. NeSmith is a member of Blue Coat's Stock Option Committee and has been since 2005. Because of NeSmith's positions, he knew, consciously disregarded, was reckless or grossly negligent in not knowing or should have known that Blue Coat insiders were improperly manipulating stock option grants to maximize their personal profits, via access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management and Board meetings and committees thereof, as well as reports and other information provided to him in connection therewith. NeSmith received at least 100,000 options that were dated at or very close to the lowest stock price for the month during which options were granted. Accordingly, on information and belief, plaintiffs allege that NeSmith manipulated these stock options and received illegal compensation from Blue Coat that was not disclosed to the Company's shareholders. Blue Coat paid NeSmith the following compensation:

Fiscal Year	Salary	Bonus	Securities Underlying Options
2006	\$250,000	\$6,963	27,000
2005	\$250,000	-	-
2004	\$135,000	-	50,000
2003	\$20,000	-	100,000
2002	\$250,000	-	-

2001	\$225,000	-	-
2000	\$175,000	-	200,000
1999	\$28,494	-	2,000,000

Defendant NeSmith sold 412,877 of his personally-held shares for \$23,437,748.01 in proceeds while in possession of material, non-public information concerning the manipulated stock option grant practices. Defendant NeSmith is a citizen of California.

20. Defendant David A. de Simone ("de Simone") is Blue Coat's Senior Vice President of Engineering and has been since September 2003. De Simone also served as an independent consultant who provided technical assistance and executive coaching to several Blue Coat clients from December 2002 to September 2003. Because of de Simone's position, he knew, consciously disregarded, was reckless or grossly negligent in not knowing or should have known that Blue Coat insiders were improperly manipulating stock option grants to maximize their personal profits, via access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management meetings, as well as reports and other information provided to him in connection therewith. De Simone received at least 180,000 options that were dated at or very close to the lowest stock price for the month during which options were granted. Accordingly, on information and belief, plaintiffs allege that de Simone manipulated these stock options and received illegal compensation from Blue Coat that was not disclosed to the Company's shareholders. Blue Coat paid de Simone the following compensation:

Fiscal Year	Salary	Bonus	Securities Underlying Options
2006	\$250,000	\$13,213	16,000
2005	\$250,000	\$137,500	-
2004	\$164,904	\$13,545	180,000

Defendant de Simone sold 55,000 of his personally-held shares for \$2,136,745.34 in proceeds while in possession of material, non-public information concerning the manipulated stock option grant practices. Defendant de Simone is a citizen of California.

21. Defendant Stephen P. Mullaney ("Mullaney") is Blue Coat's Vice President of Worldwide Marketing and has been since July 2003. Because of Mullaney's position, he knew, consciously disregarded, was reckless or grossly negligent in not knowing or should have known that



Blue Coat insiders were improperly manipulating stock option grants to maximize their personal profits, via access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management meetings, as well as reports and other information provided to him in connection therewith. Mullaney received at least 88,000 options that were dated at or very close to the lowest stock price for the month during which options were granted. Accordingly, on information and belief, plaintiffs allege that Mullaney manipulated these stock options and received illegal compensation from Blue Coat that was not disclosed to the Company's shareholders. Blue Coat paid Mullaney the following compensation:

<b>Fiscal Year</b>	<b>Salary</b>	<b>Bonus</b>	<b>Securities Underlying Options</b>
2006	\$236,891	\$5,625	15,000
2005	\$205,000	\$14,876	-
2004	\$145,747	\$10,638	88,000

Defendant Mullaney sold 25,000 of his personally-held shares for \$886,850.10 in proceeds while in possession of material, non-public information concerning the manipulated stock option grant practices. Defendant Mullaney is a citizen of California.

22. Defendant David L. Cox, Jr. ("Cox") is Blue Coat's Vice President of Operations, responsible for Manufacturing, and has been since July 2003. Because of Cox's position, he knew, consciously disregarded, was reckless or grossly negligent in not knowing or should have known that Blue Coat insiders were improperly manipulating stock option grants to maximize their personal profits, via access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management meetings, as well as reports and other information provided to him in connection therewith. Cox received at least 66,000 options that were dated at or very close to the lowest stock price for the month during which options were granted. Accordingly, on information and belief, plaintiffs allege that Cox manipulated these stock options and received illegal compensation from Blue Coat that was not disclosed to the Company's shareholders. Blue Coat paid Cox the following compensation:

Fiscal Year	Salary	Bonus	Securities Underlying Options
2004	\$151,539	\$12,500	66,000

Defendant Cox sold 17,200 of his personally-held shares for \$660,612.48 in proceeds while in possession of material, non-public information concerning the manipulated stock option grant practices. Defendant Cox is a citizen of California.

23. Defendant Cameron S. Laughlin ("Laughlin") is Blue Coat's Secretary and General Counsel and has been since October 2004. Laughlin is also Blue Coat's Vice President and has been since May 2004. Laughlin was also Blue Coat's Corporate Counsel from May 2004 to October 2004. Because of Laughlin's positions, he knew, consciously disregarded, was reckless or grossly negligent in not knowing or should have known that Blue Coat insiders were improperly manipulating stock option grants to maximize their personal profits, via access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management meetings, as well as reports and other information provided to him in connection therewith. Laughlin received at least 42,500 options that were dated at or very close to the lowest stock price for the month during which options were granted. Accordingly, on information and belief, plaintiffs allege that Laughlin manipulated these stock options and received illegal compensation from Blue Coat that was not disclosed to the Company's shareholders. Defendant Laughlin sold 11,987 of his personally-held shares for \$481,608.17 in proceeds while in possession of material, non-public information concerning the manipulated stock option grant practices. Defendant Laughlin is a citizen of California.

24. Defendant Kevin S. Royal ("Royal") is Blue Coat's Senior Vice President and Chief Financial Officer ("CFO") and has been since May 2005. Because of Royal's positions, he knew, consciously disregarded, was reckless or grossly negligent in not knowing or should have known that Blue Coat insiders were improperly manipulating stock option grants to maximize their personal profits, via access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management meetings, as well as reports and other information provided to him in connection therewith. Defendant Royal received 75,000

1 springloaded options timed immediately before the release of positive-previously-undisclosed  
2 material information. Blue Coat paid Royal the following compensation:

Fiscal Year	Salary	Bonus	Securities Underlying Options
2006	\$300,000	\$9,234	75,000

6 Defendant Royal is a citizen of California.

7       25. Defendant David W. Hanna ("Hanna") is Blue Coat's Chairman of the Board and has  
8 been since February 2001. Hanna also has been a Blue Coat director since October 1996. Hanna  
9 was also Blue Coat's interim President and CEO from December 1998 to March 1999. Hanna is a  
10 member of Blue Coat's Audit Committee and has been since 2001 and a member of the  
11 Compensation Committee and has been since 2000. Because of Hanna's positions, he knew,  
12 consciously disregarded, was reckless or grossly negligent in not knowing or should have known that  
13 Blue Coat insiders were improperly manipulating stock option grants to maximize their personal  
14 profits, via access to internal corporate documents, conversations and connections with other  
15 corporate officers and employees, attendance at Board meetings and committees thereof, as well as  
16 reports and other information provided to him in connection therewith. Hanna received at least  
17 17,000 options that were dated at or very close to the lowest stock price for the month during which  
18 options were granted. Accordingly, on information and belief, plaintiffs allege that Hanna  
19 manipulated these stock options and received illegal compensation from Blue Coat that was not  
20 disclosed to the Company's shareholders. Defendant Hanna sold 64,135 of his personally-held  
21 shares for \$3,356,221.65 in proceeds while in possession of material, non-public information  
22 concerning the illegally undisclosed manipulated stock option grant practices. Defendant Hanna is a  
23 citizen of California.

24       26. Defendant James A. Barth ("Barth") is a Blue Coat director and has been since  
25 January 2005. Barth is Chairman of Blue Coat's Audit Committee and has been since 2005 and a  
26 member of the Compensation Committee and has been since 2005. Because of Barth's positions, he  
27 knew, consciously disregarded, was reckless or grossly negligent in not knowing or should have  
28 known that Blue Coat insiders were improperly manipulating stock option grants to maximize their

1 personal profits, via access to internal corporate documents, conversations and connections with  
2 other corporate officers and employees, attendance at Board meetings and committees thereof, as  
3 well as reports and other information provided to him in connection therewith. Defendant Barth is a  
4 citizen of California.

5 27. Defendant Timothy A. Howes ("Howes") is a Blue Coat director and has been since  
6 December 2005. Howes is a member of Blue Coat's Audit Committee and has been since 2006.  
7 Because of Howes' positions, he knew, consciously disregarded, was reckless or grossly negligent in  
8 not knowing or should have known that Blue Coat insiders were improperly manipulating stock  
9 option grants to maximize their personal profits, via access to internal corporate documents,  
10 conversations and connections with other corporate officers and employees, attendance at Board  
11 meetings and committees thereof, as well as reports and other information provided to him in  
12 connection therewith. Defendant Howes is a citizen of California.

13 28. Defendant Keith Geeslin ("Geeslin") is a Blue Coat director and has been since  
14 June 2006. Geeslin is a member of Blue Coat's Stock Option Committee and has been since 2007.  
15 Because of Geeslin's positions, he knew, consciously disregarded, was reckless or grossly negligent  
16 in not knowing or should have known that Blue Coat insiders were improperly manipulating stock  
17 option grants to maximize their personal profits, via access to internal corporate documents,  
18 conversations and connections with other corporate officers and employees, attendance at Board  
19 meetings and committees thereof, as well as reports and other information provided to him in  
20 connection therewith. Defendant Geeslin is a citizen of California.

21 29. Defendant Michael A. Malcolm ("Malcolm") was Blue Coat's Chairman of the Board  
22 from March 1996 to November 2000. Malcolm was also Blue Coat's President and CEO from June  
23 1997 to December 1998. Because of Malcolm's positions, he knew, consciously disregarded, was  
24 reckless or grossly negligent in not knowing or should have known that Blue Coat insiders were  
25 improperly manipulating stock option grants to maximize their personal profits, via access to internal  
26 corporate documents, conversations and connections with other corporate officers and employees,  
27 attendance at management and Board meetings and committees thereof, as well as reports and other  
28 information provided to him in connection therewith. Defendant Malcolm sold 500,000 of his

1 personally-held shares for \$42,109,690 in proceeds while in possession of material, non-public  
 2 information concerning the manipulated stock option grant practices. Defendant Malcolm is a  
 3 citizen of California.

4 30. Defendant Johnson was Blue Coat's Vice President, CFO from July 1999 to March  
 5 2001. Johnson was Blue Coat's Secretary from about September 1999 to at least November 1999.  
 6 Because of Johnson's positions, he knew, consciously disregarded, was reckless or grossly negligent  
 7 in not knowing or should have known that Blue Coat insiders were improperly manipulating stock  
 8 option grants to maximize their personal profits, via access to internal corporate documents,  
 9 conversations and connections with other corporate officers and employees, attendance at  
 10 management meetings, as well as reports and other information provided to him in connection  
 11 therewith. Johnson received at least 30,000 options that were dated at or very close to the lowest  
 12 stock price for the month during which options were granted. Accordingly, on information and  
 13 belief, plaintiffs allege that Johnson manipulated these stock options and received illegal  
 14 compensation from Blue Coat that was not disclosed to the Company's shareholders. Blue Coat paid  
 15 Johnson the following compensation:

	<b>Fiscal</b>		<b>Securities</b>
	<b>Year</b>	<b>Salary</b>	<b>Underlying</b>
			<b>Options</b>
	2001	\$204,850	-
	2000	\$137,199	490,000

19 Defendant Johnson sold 137,694 of his personally-held shares for \$10,921,802.47 in proceeds while  
 20 in possession of material, non-public information concerning the manipulated stock option grant  
 21 practices. Defendant Johnson is a citizen of South Dakota.

22 31. Defendant Robin was Blue Coat's Senior Vice President, Worldwide Sales from July  
 23 1999 to April 2002. Because of Robin's position, he knew, consciously disregarded, was reckless or  
 24 grossly negligent in not knowing or should have known that Blue Coat insiders were improperly  
 25 manipulating stock option grants to maximize their personal profits, via access to internal corporate  
 26 documents, conversations and connections with other corporate officers and employees, attendance  
 27 at management meetings, as well as reports and other information provided to him in connection  
 28 therewith. Robin received at least 60,000 options that were dated at or very close to the lowest stock

price for the month during which options were granted. Accordingly, on information and belief, plaintiffs allege that Robin manipulated these stock options and received illegal compensation from Blue Coat that was not disclosed to the Company's shareholders. Blue Coat paid Robin the following compensation:

<b>Fiscal Year</b>	<b>Salary</b>	<b>Bonus</b>	<b>Restricted Stock Awards (number of shares)</b>	<b>Securities Underlying Options</b>
2002	\$390,384	\$117,997	-	150,000
2001	\$200,000	\$169,259	75,000	-
2000	\$115,385	\$471,523	-	622,000

Defendant Robin sold 125,000 of his personally-held shares for \$10,711,831.35 in proceeds while in possession of material, non-public information concerning the manipulated stock option grant practices. Defendant Robin is a citizen of California.

32. Defendant Robert Verheecke ("Verheecke") was Blue Coat's Senior Vice President, CFO and Secretary from May 2001 to May 2005. From May 2005 to January 2006, Verheecke remained a Blue Coat employee who was responsible for projects related to business development and financial systems implementation. Because of Verheecke's positions, he knew, consciously disregarded, was reckless or grossly negligent in not knowing or should have known that Blue Coat insiders were improperly manipulating stock option grants to maximize their personal profits, via access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management meetings, as well as reports and other information provided to him in connection therewith. Verheecke received at least 250,000 options that were dated at or very close to the lowest stock price for the month during which options were granted. Accordingly, on information and belief, plaintiffs allege that Verheecke manipulated these stock options and received illegal compensation from Blue Coat that was not disclosed to the Company's shareholders. Blue Coat paid Verheecke the following compensation:

<b>Fiscal Year</b>	<b>Salary</b>	<b>Bonus</b>	<b>Securities Underlying Options</b>
2005	\$250,000	\$18,125	-
2004	\$250,000	\$20,625	40,000
2003	\$250,000	\$18,750	50,000
2002	\$231,250	\$28,125	100,000

1 Defendant Verheecke sold 22,000 of his personally-held shares for \$1,020,080.50 in proceeds while  
 2 in possession of material, non-public information concerning the manipulated stock option grant  
 3 practices. Defendant Verheecke is a citizen of California.

4 33. Defendant John M. Scharber ("Scharber") was Blue Coat's Vice President and Chief  
 5 Technology Officer ("CTO") from May 2001 to July 2001. Scharber was also Blue Coat's Vice  
 6 President of Research and Development for Streaming Technology from December 2000 to May  
 7 2001. Because of Scharber's positions, he knew, consciously disregarded, was reckless or grossly  
 8 negligent in not knowing or should have known that Blue Coat insiders were improperly  
 9 manipulating stock option grants to maximize their personal profits, via access to internal corporate  
 10 documents, conversations and connections with other corporate officers and employees, attendance  
 11 at management meetings, as well as reports and other information provided to him in connection  
 12 therewith. Scharber received at least 65,000 options that were dated at or very close to the lowest  
 13 stock price for the month during which options were granted. Accordingly, on information and  
 14 belief, plaintiffs allege that Scharber manipulated these stock options and received illegal  
 15 compensation from Blue Coat that was not disclosed to the Company's shareholders. Blue Coat paid  
 16 Scharber the following compensation:

	<b>Fiscal Year</b>	<b>Salary</b>	<b>Securities Underlying Options</b>
18	2002	\$155,316	-
19	2001	\$73,125	425,000

20 Defendant Scharber sold 60,000 of his personally-held shares for \$351,730 in proceeds while in  
 21 possession of material, non-public information concerning the manipulated stock option grant  
 22 practices. Defendant Scharber is a citizen of California.

23 34. Defendant Tom Ayers ("Ayers") was Blue Coat's Senior Vice President of Worldwide  
 24 Field Operations from November 2004 to November 2006 and remained a Blue Coat employee, until  
 25 April 2007. Ayers was also Blue Coat's Senior Vice President of Sales from October 2002 to  
 26 November 2004. Because of Ayers' positions, he knew, consciously disregarded, was reckless or  
 27 grossly negligent in not knowing or should have known that Blue Coat insiders were improperly  
 28 manipulating stock option grants to maximize their personal profits, via access to internal corporate

documents, conversations and connections with other corporate officers and employees, attendance at management meetings, as well as reports and other information provided to him in connection therewith. Defendant Ayers received 35,000 springloaded options timed immediately before the release of positive-previously-undisclosed material information. Blue Coat paid Ayers the following compensation:

<b>Fiscal Year</b>	<b>Salary</b>	<b>Bonus</b>	<b>Securities Underlying Options</b>
2006	\$200,000	\$190,094	25,000
2005	\$187,500	\$162,784	-
2004	\$175,000	\$150,857	35,000
2003	\$90,192	\$41,732	66,000

Defendant Ayers is a citizen of Texas.

35. Defendant Vasudevan was Blue Coat's CTO from August 1997 to April 2001. Because of Vasudevan's position, he knew, consciously disregarded, was reckless or grossly negligent in not knowing or should have known that Blue Coat insiders were improperly manipulating stock option grants to maximize their personal profits, via access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management meetings, as well as reports and other information provided to him in connection therewith. Vasudevan received at least 24,000 options that were dated at or very close to the lowest stock price for the month during which options were granted. Accordingly, on information and belief, plaintiffs allege that Vasudevan manipulated these stock options and received illegal compensation from Blue Coat that was not disclosed to the Company's shareholders. Blue Coat paid Vasudevan the following compensation:

<b>Fiscal Year</b>	<b>Salary</b>	<b>Securities Underlying Options</b>
2000	\$150,000	120,000
1999	\$149,907	-

Defendant Vasudevan is a citizen of California.

36. Defendant Warner was Blue Coat's Vice President of Business Development from August 1999 to April 2001. Warner was also Cacheflow's Vice President of Sales from September 1997 to August 1999. Because of Warner's positions, he knew, consciously disregarded, was



reckless or grossly negligent in not knowing or should have known that Blue Coat insiders were improperly manipulating stock option grants to maximize their personal profits, via access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management meetings, as well as reports and other information provided to him in connection therewith. Warner received at least 4,000 options that were dated at or very close to the lowest stock price for the month during which options were granted. Accordingly, on information and belief, plaintiffs allege that Warner manipulated these stock options and received illegal compensation from Blue Coat that was not disclosed to the Company's shareholders. Blue Coat paid Warner the following compensation:

<b>Fiscal Year</b>	<b>Salary</b>	<b>Bonus</b>	<b>Securities Underlying Options</b>
2000	\$150,000	\$48,085	20,000
1999	\$149,889	\$40,000	-

Defendant Warner is a citizen of California.

37. Defendant Susan Hovatter Thornton ("Thornton") was Blue Coat's Vice President, General Counsel and Assistant Secretary from January 2000 to at least May 2001. Because of Thornton's positions, she knew, consciously disregarded, was reckless or grossly negligent in not knowing or should have known that Blue Coat insiders were improperly manipulating stock option grants to maximize their personal profits, via access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management meetings, as well as reports and other information provided to her in connection therewith. Defendant Thornton is a citizen of California.

38. Defendant Stuart Phillips ("Phillips") was a Blue Coat director from January 1997 to June 2001. Phillips was also a member of the Audit Committee from 1999 to 2002 and a member of the Compensation Committee from 2000 to 2001. Because of Phillips' positions, he knew, consciously disregarded, was reckless or grossly negligent in not knowing or should have known that Blue Coat insiders were improperly manipulating stock option grants to maximize their personal profits, via access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at Board meetings and committees thereof, as well as

1 reports and other information provided to him in connection therewith. Defendant Phillips sold  
2 3,160,490 of his personally-held shares for \$252,836,524.46 in proceeds while in possession of  
3 material, non-public information concerning the illegally undisclosed manipulated stock option grant  
4 practices. Defendant Phillips is a citizen of California.

5 39. Defendant Marc Andreessen ("Andreessen") was a Blue Coat director from October  
6 1999 to September 2005. Andreessen was also a member of the Audit Committee from 2003 to  
7 2005. Because of Andreessen's positions, he knew, consciously disregarded, was reckless or grossly  
8 negligent in not knowing or should have known that Blue Coat insiders were improperly  
9 manipulating stock option grants to maximize their personal profits, via access to internal corporate  
10 documents, conversations and connections with other corporate officers and employees, attendance  
11 at Board meetings and committees thereof, as well as reports and other information provided to him  
12 in connection therewith. Defendant Andreessen sold 282,044 of his personally-held shares for  
13 \$12,193,497.09 in proceeds while in possession of material, non-public information concerning the  
14 illegally undisclosed manipulated stock option grant practices. Defendant Andreessen is a citizen of  
15 California.

16 40. Defendant Andrew S. Rachleff ("Rachleff") was a Blue Coat director from  
17 October 1997 to September 2005. Rachleff was also a member of the Audit Committee from 1999  
18 to 2005 and a member of the Compensation Committee from 2003 to 2005. Because of Rachleff's  
19 positions, he knew, consciously disregarded, was reckless or grossly negligent in not knowing or  
20 should have known that Blue Coat insiders were improperly manipulating stock option grants to  
21 maximize their personal profits, via access to internal corporate documents, conversations and  
22 connections with other corporate officers and employees, attendance at Board meetings and  
23 committees thereof, as well as reports and other information provided to him in connection  
24 therewith. Defendant Rachleff is a citizen of California.

25 41. Defendant Philip J. Koen ("Koen") was a Blue Coat director from June 2001 to  
26 August 2003. Koen was also a member of the Audit Committee from 2001 to 2003 and a member of  
27 the Compensation Committee from 2001 to 2003. Because of Koen's positions, he knew,  
28 consciously disregarded, was reckless or grossly negligent in not knowing or should have known that

1 Blue Coat insiders were improperly manipulating stock option grants to maximize their personal  
2 profits, via access to internal corporate documents, conversations and connections with other  
3 corporate officers and employees, attendance at Board meetings and committees thereof, as well as  
4 reports and other information provided to him in connection therewith. Defendant Koen is a citizen  
5 of Texas.

6 42. Defendant E&Y was engaged by Blue Coat to provide independent auditing and/or  
7 consulting services to the Company, including the preparation, examination and/or review of Blue  
8 Coat's annual and interim financial statements for the period November 1999 to the present, during  
9 which financial statements were disseminated to Blue Coat shareholders and filed with the SEC.  
10 E&Y was engaged to perform and performed these services so that Blue Coat's financial statements  
11 would be presented to, and reviewed and relied upon by Blue Coat shareholders, governmental  
12 agencies, the investing public and members of the financial community. As a result of the services it  
13 rendered to Blue Coat, E&Y's representatives were frequently present at Blue Coat's corporate  
14 headquarters and financial offices from November 1999 to the present. Thus, E&Y's representatives  
15 had continual access to Blue Coat's confidential, non-public corporate financial and business  
16 information, including information concerning the Company's executive compensation and stock  
17 option data and its true financial condition and financial statements, which information E&Y  
18 representatives were aware of and/or consciously or negligently disregarded. E&Y actively  
19 participated in the presentation, review and issuance of Blue Coat's improper financial statements.  
20 E&Y issued unqualified audit reports on Blue Coat's financial statements for the period from  
21 November 1999 to the present. E&Y also reviewed the Company's interim financial statements.  
22 Defendant E&Y is headquartered in New York.

23 43. The defendants identified in ¶¶19, 25-29, 38-41 are referred to herein as the "Director  
24 Defendants." The defendants identified in ¶¶19-25, 29-37 are referred to herein as the "Officer  
25 Defendants." The defendants identified in ¶¶19-23, 25, 29-33, 38-39 are referred to herein as the  
26 "Insider Selling Defendants." The defendants identified in ¶¶19-25, 30-36 are referred to herein as  
27 the "Options Recipient Defendants." Collectively, the Director Defendants, the Officer Defendants,  
28

1 the Insider Selling Defendants and the Option Recipient Defendants are referred to herein as the  
2 "Individual Defendants."

3 **DUTIES OF THE INDIVIDUAL DEFENDANTS**

4 44. By reason of their positions as officers, directors and/or fiduciaries of Blue Coat and  
5 because of their ability to control the business and corporate affairs of the Company, the Individual  
6 Defendants owed Blue Coat and its shareholders fiduciary obligations of trust, loyalty, good faith  
7 and due care and were and are required to use their utmost ability to control and manage Blue Coat  
8 in a fair, just, honest and equitable manner. The Individual Defendants were and are required to act  
9 in furtherance of the best interests of Blue Coat and its shareholders so as to benefit all shareholders  
10 equally and not in furtherance of the personal interest or benefit of the Individual Defendants.

11 45. Each director and officer of the Company owes to Blue Coat and its shareholders the  
12 fiduciary duty to exercise good faith and diligence in the administration of the affairs of the  
13 Company and in the use and preservation of its property and assets and the highest obligations of fair  
14 dealing. In addition, as officers and/or directors of a publicly-held company, the Individual  
15 Defendants had a duty to promptly disseminate accurate and truthful information with regard to the  
16 compensation paid to its executives, directors and employees. These disclosures necessarily include  
17 the value of stock options granted to the Company's insiders.

18 46. The Individual Defendants, because of their positions of control and authority as  
19 directors and/or officers of Blue Coat, were able to and did, directly and/or indirectly, exercise  
20 control over the wrongful acts complained of herein, as the Company's disclosures of its financial  
21 results including expenses related to stock option grants. Because of their advisory, executive,  
22 managerial and directorial positions with Blue Coat, each of the Individual Defendants had access to  
23 adverse, non-public information about the financial condition and improper representations of Blue  
24 Coat.

25 47. At all times relevant hereto, each of the Individual Defendants was the agent of each  
26 of the other Individual Defendants and of Blue Coat and was at all times acting within the course and  
27 scope of such agency.

28

1           48. To properly discharge their duties, Blue Coat's officers and directors were required to  
2 exercise reasonable and prudent supervision over the management, policies, practices and controls of  
3 the financial affairs of the Company. By virtue of such duties, the officers and directors of Blue  
4 Coat were required to, among other things:

5           (a) Ensure that the Company complied with its legal obligations and  
6 requirements, including acting only within the scope of its legal authority and disseminating truthful  
7 and accurate statements to the SEC and the investing public;

8           (b) Conduct the affairs of the Company in an efficient, business-like manner so as  
9 to make it possible to provide accurate disclosures of the Company's financials and to avoid wasting  
10 the Company's assets;

11           (c) Properly and accurately guide investors and analysts as to the true financial  
12 condition of the Company at any given time, including making accurate statements about the  
13 Company's financial results and ensuring that the Company maintained an adequate system of  
14 internal controls such that the Company's financial reporting would be true and accurate at all times;

15           (d) Remain informed as to Blue Coat's internal controls and, upon receipt of  
16 notice or information of imprudent or unsound conditions or practices, to make reasonable inquiry in  
17 connection therewith, and to take steps to correct such conditions or practices and make such  
18 disclosures as necessary to comply with federal and state securities laws;

19           (e) Ensure that Blue Coat was properly handling its tax liabilities;

20           (f) Ensure that Blue Coat's internal controls were sufficient to prevent stock  
21 option manipulations, including, but not limited to, backdating and springloading; and

22           (g) Ensure that the Company was operated in a diligent, honest and prudent  
23 manner in compliance with all applicable federal, state and local laws, rules and regulations.

24           49. Each Individual Defendant, by virtue of his or her position as a director and/or  
25 officer, owed to the Company and to its shareholders the fiduciary duties of loyalty, good faith and  
26 the exercise of due care and diligence in the management and administration of the affairs of the  
27 Company, as well as in the use and preservation of its property and assets. The conduct of the  
28 Individual Defendants complained of herein involves a knowing and culpable violation of their

1 fiduciary obligations as directors and officers of Blue Coat, the absence of good faith on their part  
2 and a reckless disregard for their duties to the Company and its shareholders that the Individual  
3 Defendants were aware or should have been aware posed a risk of serious injury to the Company.  
4 The conduct of the Individual Defendants who were also officers and/or directors of the Company  
5 has been ratified by the remaining Individual Defendants who collectively comprise all of Blue  
6 Coat's Board.

7 50. The Individual Defendants breached their duties of loyalty and good faith by allowing  
8 defendants to cause or by themselves causing the Company to misrepresent its financial results, as  
9 detailed herein *infra* and by failing to prevent the Individual Defendants from taking such improper  
10 actions. As a result of the defendants' improprieties, the Company has and will need to expend  
11 significant sums of money.

12 **STANDARDS APPLICABLE TO E&Y**

13 51. The objective of audits of financial statements by independent auditors such as E&Y  
14 is for the auditor to express an opinion on the fairness with which such statements present, in all  
15 material respects, the Company's financial position, results of operations and cash flows in  
16 conformity with Generally Accepted Accounting Principles ("GAAP"). E&Y's report is the medium  
17 through which it expresses its opinion or, if circumstances require, qualifies or disclaims an opinion.  
18 In either case, E&Y states that its audit has been in accordance with Generally Accepted Auditing  
19 Standards ("GAAS"). These standards require E&Y to state whether, in its opinion, Blue Coat's  
20 financial statements are presented in accordance with GAAP and to identify those circumstances in  
21 which such principles have not been consistently observed in the preparation of the financial  
22 statements of the current period in relation to those of the preceding period.

23 52. GAAS, as approved and adopted by the American Institute of Certified Public  
24 Accountants ("AICPA"), are comprised of 10 standards. These standards to a great extent are  
25 interrelated and interdependent. E&Y is responsible for compliance with GAAS in an audit  
26 engagement. The 10 standards are as follows:

1 **General Standards**

2 (a) The audit is to be performed by a person or persons having adequate technical  
3 training and proficiency as an auditor.

4 (b) In all matters relating to the assignment, an independence in mental attitude is  
5 to be maintained by the auditor or auditors.

6 (c) Due professional care is to be exercised in the performance of the audit and  
7 the preparation of the report.

8 **Standards of Fieldwork**

9 (a) The work is to be adequately planned and assistants, if any, are to be properly  
10 supervised.

11 (b) A sufficient understanding of the internal control structure is to be obtained to  
12 plan the audit and to determine the nature, timing and extent of tests to be performed

13 (c) Sufficient competent evidential matter is to be obtained through inspection,  
14 observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the  
15 financial statements under audit.

16 **Standards of Reporting**

17 (a) The report shall state whether the financial statements are presented in  
18 accordance with GAAP.

19 (b) The report shall identify those circumstances in which such principles have  
20 not been consistently observed in the current period in relation to the preceding period.

21 (c) Informative disclosures in the financial statements are to be regarded as  
22 reasonably adequate unless otherwise stated in the report.

23 (d) The report shall either contain an expression of opinion regarding the financial  
24 statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When  
25 an overall opinion cannot be expressed, the reasons therefore should be stated. In all cases where an  
26 auditor's name is associated with financial statements, the report should contain a clear-cut indication  
27 of the character of the auditor's work, if any, and the degree of responsibility the auditor is taking.  
28

1           53. E&Y is one of the largest international firms of certified public accountants and is a  
2 member of the AICPA. E&Y was the auditor of Blue Coat's financial statements between November  
3 1999 and the present. In addition, it was paid to review the quarterly financial statements of Blue  
4 Coat throughout this period. E&Y audited Blue Coat's financial statements issued between  
5 November 1999 and the present, and issued its audit opinions stating that those financial statements  
6 were fairly presented in accordance with GAAP and that it had audited those financial statements in  
7 accordance with GAAS. Both of those statements were false. E&Y was aware of facts that  
8 undeniably precluded it from making those statements at the time they were made. Blue Coat's  
9 financial statements and E&Y's opinions on them were then used by Blue Coat with E&Y's consent  
10 to publicly disseminate Blue Coat's financial results in the filing of its annual Forms 10-K with the  
11 SEC.

12           54. As Blue Coat's independent accountant, E&Y was negligent in failing to comply with  
13 GAAS. E&Y issued unqualified opinions stating that financial statements of Blue Coat were fairly  
14 presented in accordance with GAAP, when E&Y was aware of or should have been aware of facts  
15 and circumstances that materially undermined such unqualified opinions and rendered them false  
16 and misleading.

17           **THE BOARD AND ITS COMMITTEES' DUTIES CONCERNING BLUE COAT'S**  
18           **STOCK OPTION PLANS AND OPTION GRANT PRACTICES**

19           55. The granting of stock options to Blue Coat insiders, at times relevant hereto, was  
20 governed by two plans: the 1999 Stock Incentive Plan ("1999 Plan") and the 2000 Supplemental  
21 Stock Option Plan ("2000 Plan"). The 1999 and 2000 Plans are collectively referred to herein as the  
22 "Plans."

23           **The 1999 Plan**

24           56. The 1999 Plan provides for the granting of incentive stock options and non-statutory  
25 stock options. Incentive stock options are options that may only be granted to employees under  
26 certain conditions prescribed by the federal tax code in order to achieve certain tax benefits. Non-  
27 statutory stock options are not restricted by the tax code and do not have the tax benefits of incentive  
28 stock options.



1           57.     The 1999 Plan restricted the exercise price of incentive stock option grants in order to  
2 comply with the tax code. Specifically, the 1999 Plan provides that the exercise price "shall in no  
3 event be less than 100% of the Fair Market Value of a Common Share on the date of grant ...."

4           58.     The 1999 Plan also restricted the exercise price of non-statutory stock options to no  
5 "less than 85% of the Fair Market Value of a Common Share on the date of grant."

6           59.     The 1999 Plan was administered by a committee of at least two Board members. The  
7 1998 Plan specifically provides that "[t]he Plan shall be administered by the Committee. The  
8 Committee shall consist exclusively of two or more directors of the Company, who shall be  
9 appointed by the Board." According to Blue Coat's 2001 annual proxy, the Compensation  
10 Committee had the authority to administer Blue Coat's stock option plans.

11          60.     The Compensation Committee had the following authority under the 1999 Plan:

12           The Committee shall (a) select the Employees, Outside Directors and Consultants  
13 who are to receive Awards under the Plan, (b) determine the type, number, vesting  
14 requirements and other features and conditions of such Awards, (c) interpret the Plan  
15 and (d) make all other decisions relating to the operation of the Plan. The Committee  
16 may adopt such rules or guidelines as it deems appropriate to implement the Plan.

#### 16                   **The 2000 Plan**

17          61.     The 2000 Plan only provides for the grant of non-statutory stock options.

18          62.     The 2000 Plan restricts the exercise price of non-statutory stock options to no "less  
19 than 25% of the Fair Market Value of a Common Share on the date of grant."

20          63.     The 2000 Plan was administered by a committee of at least two Board members. The  
21 2000 Plan specifically provides that "[t]he Plan shall be administered by the Committee. The  
22 Committee shall consist exclusively of two or more directors of the Company, who shall be  
23 appointed by the Board." According to Blue Coat's 2001 annual proxy, the Compensation  
24 Committee had the authority to administer Blue Coat's stock option plans.

25          64.     The Compensation Committee had the following authority under the 2000 Plan:

26           The Committee shall (a) select the Employees, Outside Directors and Consultants  
27 who are to receive Awards under the Plan, (b) determine the type, number, vesting  
28 requirements and other features and conditions of such Awards, (c) interpret the Plan  
and (d) make all other decisions relating to the operation of the Plan. The Committee  
may adopt such rules or guidelines as it deems appropriate to implement the Plan.

**The Board and Its Committees Violated Blue Coat's Stock Option Plans**

65. The Options Recipient Defendants' manipulated stock options were granted below fair market value in the case of incentive stock options. As to non-statutory stock options, the Options Recipient Defendants' manipulated stock options and used improper measurement dates that resulted in the actual grant date differing from the disclosed grant date. Thus, the Compensation Committee, which had the authority and responsibility to approve the manipulated option grants, violated the Plans. Further, defendants' options manipulation practices resulted in truncated stock-option vesting periods—a further violation of the Plans. In turn, because the Plans were violated, the manipulated options granted under these Plans must be cancelled and declared void.

66. Blue Coat's Audit Committee also played a role in the options manipulation. According to the Audit Committee's charter effective during 2000, the Audit Committee was responsible for reviewing Blue Coat's significant accounting and reporting principles, policies and practices. These principles, policies and practices included Blue Coat's adherence to SFAS No. 123, "Accounting for Stock-Based Compensation" and Accounting Principles Board Opinion No. 25 ("APB 25"). Under SFAS No. 123 and APB 25, a compensation expense must be taken if options are not granted at fair market value. Because defendants' illegally manipulated options resulted in below fair market value grants, Blue Coat was forced to restate its prior financials to record stock option compensation expenses.

67. Blue Coat created a Stock Option Committee during May 2005. According to its charter, the Stock Option Committee was and is responsible for stock option grants to Blue Coat consultants and employee, but not executive officers.

68. Accordingly, defendants NeSmith, Hanna, Barth, Howes, Geeslin, Malcolm, Phillips and Andreessen, who were directors between 1999 and 2005, were directly responsible for the stock-option backdating improprieties. Thus, these defendants are also liable to Blue Coat in addition to the defendants who received backdated options. The following chart details the defendants and other individuals who held positions on the Board and Audit Committees when Blue Coat granted stock options that were suspiciously dated at or near monthly low stock prices or before significant appreciations in stock price:

Manipulated Options Grant Date	Audit Committee Members	Compensation Committee Members	Stock Option Committee	Directors
April 17, 2000	Phillips, Rachleff	Hanna, Phillips	-	Andreessen, Hanna, Malcolm, NeSmith, Phillips, Rachleff
April 4, 2001	Phillips, Rachleff	Hanna, Phillips	-	Andreessen, Hanna, Phillips, NeSmith, Rachleff
May 1, 2001	Phillips, Rachleff	Hanna, Phillips	-	Andreessen, Hanna, Phillips, NeSmith, Rachleff
July 10, 2002	Hanna, Koen, Rachleff	Hanna, Koen	-	Andreessen, Hanna, Koen, NeSmith, Rachleff
July 30, 2003	Hanna, Koen, Rachleff	Hanna, Koen	-	Andreessen, Hanna, Koen, NeSmith, Rachleff
February 4, 2004	Andreessen, Hanna, Rachleff	Hanna, Rachleff	-	Andreessen, Hanna, NeSmith, Rachleff
May 28, 2004	Andreessen, Hanna, Rachleff	Hanna, Rachleff	-	Andreessen, Hanna, NeSmith, Rachleff, Shiveley <sup>1</sup>
August 26, 2004	Andreessen, Hanna, Rachleff	Hanna, Rachleff	-	Andreessen, Hanna, NeSmith, Rachleff, Shiveley
May 2, 2005	Barth, Hanna, Rachleff	Hanna, Rachleff	-	Andreessen, Barth, Hanna, NeSmith, Rachleff, Shiveley
August 16, 2005	Barth, Hanna, Rachleff	Hanna, Rachleff	NeSmith	Andreessen, Barth, Hanna, NeSmith, Rachleff, Shiveley

### CONSPIRACY, AIDING AND ABETTING AND CONCERTED ACTION

69. In committing the wrongful acts alleged herein, the Individual Defendants have pursued, or joined in the pursuit of, a common course of conduct and have acted in concert with and conspired with one another in furtherance of their common plan or design. In addition to the wrongful conduct herein alleged as giving rise to primary liability, the Individual Defendants further aided and abetted and/or assisted each other in breach of their respective duties.

70. During all times relevant hereto, the Individual Defendants collectively and individually initiated a course of conduct that was designed to and did: (i) conceal the fact that Company insiders were improperly manipulating their stock option grants; (ii) conceal the fact that

<sup>1</sup> As defined in ¶132, *infra*.

1 as a result of the improperly manipulated stock option grants, the Company's financial statements  
2 were inaccurate; (iii) maintain the Individual Defendants' executive and directorial positions at Blue  
3 Coat and the profits, power and prestige that the Individual Defendants enjoyed as a result of these  
4 positions; (iv) deceive the shareholders of Blue Coat, regarding the level of compensation being paid  
5 to the Company's insiders and the Company's financial condition and future business prospects; and  
6 (v) artificially inflate the price of Blue Coat common stock so they could dispose of over \$48 million  
7 of their personally held stock. In furtherance of this plan, conspiracy and course of conduct, the  
8 Individual Defendants collectively and individually took the actions set forth herein.

9       71. The Individual Defendants engaged in a conspiracy, common enterprise and/or  
10 common course of conduct. During such time, the Individual Defendants caused the Company to  
11 conceal the true fact that Blue Coat was misrepresenting its financial results and that Blue Coat  
12 insiders were improperly manipulating their stock option grants.

13       72. The purpose and effect of the Individual Defendants' conspiracy, common enterprise,  
14 and/or common course of conduct was, among other things, to grant themselves and other insiders  
15 undisclosed and unaccounted for compensation in the form of manipulated stock option grants and to  
16 disguise the Individual Defendants' violations of law, breaches of fiduciary duty, insider trading,  
17 abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment.

18       73. The Individual Defendants accomplished their conspiracy, common enterprise and/or  
19 common course of conduct by causing the Company to purposefully, recklessly or negligently  
20 misrepresent its financial results. Because the actions described herein occurred under the authority  
21 of the Board, each of the Individual Defendants was a direct, necessary and substantial participant in  
22 the conspiracy, common enterprise and/or common course of conduct complained of herein.

23       74. Each of the Individual Defendants aided and abetted and rendered substantial  
24 assistance in the wrongs complained of herein. In taking such actions to substantially assist the  
25 commission of the wrongdoing complained of herein, each Individual Defendant acted with  
26 knowledge of the primary wrongdoing, substantially assisted the accomplishment of that  
27 wrongdoing and was aware of his or her overall contribution to and furtherance of the wrongdoing.  
28

## THE STOCK OPTION BACKDATING SCANDAL

75. The traditional rationale behind the granting of stock options is to align the interests of a company's officers, directors and employees with the interests of the company's shareholders. When an option is granted at or below full market value, that option is worthless until the grantee creates value in the option by building value in the company. In such a case, the option grantee and shareholders share in the value created. The backdating of options, however, subverts this principle because the instant paper gain of a backdated stock option only benefits the insider.

76. On March 18, 2006, the *Wall Street Journal* published an article entitled: "The Perfect Payday: Some CEOs reap millions by landing stock options when they are most valuable. Luck – or something else?" The article stated in pertinent part:

On a summer day in 2002, shares of Affiliated Computer Services Inc. sank to their lowest level in a year. Oddly, that was good news for Chief Executive Jeffrey Rich.

His annual grant of stock options was dated that day, entitling him to buy stock at that price for years. Had they been dated a week later, when the stock was 27% higher, they'd have been far less rewarding. It was the same through much of Mr. Rich's tenure: In a striking pattern, all six of his stock-option grants from 1995 to 2002 were dated just before a rise in the stock price, often at the bottom of a steep drop.

Just lucky? A Wall Street Journal analysis suggests the odds of this happening by chance are extraordinarily remote -- around one in 300 billion. The odds of winning the multistate Powerball lottery with a \$1 ticket are one in 146 million.

Suspecting such patterns aren't due to chance, the Securities and Exchange Commission is examining whether some option grants carry favorable grant dates for a different reason: They were backdated. The SEC is understood to be looking at about a dozen companies' option grants with this in mind.

The Journal's analysis of grant dates and stock movements suggests the problem may be broader. It identified several companies with wildly improbable option-grant patterns. While this doesn't prove chicanery, it shows something very odd: Year after year, some companies' top executives received options on unusually propitious dates.

The analysis bolsters recent academic work suggesting that backdating was widespread, particularly from the start of the tech-stock boom in the 1990s through the Sarbanes-Oxley corporate reform act of 2002. If so, it was another way some executives enriched themselves during the boom at shareholders' expense. And because options grants are long-lived, some executives holding backdated grants from the late 1990s could still profit from them today.

\* \* \*

Stock options give recipients a right to buy company stock at a set price, called the exercise price or strike price. The right usually doesn't vest for a year or more, but then it continues for several years. The exercise price is usually the stock's 4 p.m. price on the date of the grant, an average of the day's high and low, or the 4 p.m. price the day before. Naturally, the lower it is, the more money the recipient can potentially make someday by exercising the options.

Which day's price the options carry makes a big difference. Suppose an executive gets 100,000 options on a day when the stock is at \$30. Exercising them after it has reached \$50 would bring a profit of \$20 times 100,000, or \$2 million. But if the grant date was a month earlier and the stock then was at, say, \$20, the options would bring in an extra \$1 million.

77. Lynn Turner, former Chief Accountant of the SEC, has described stock option backdating as follows: "It's like allowing people to place bets on a horse race after the horses have crossed the finish line ...." In a recent article published by the *Wall Street Journal*, Arthur Levitt, a former chairman of the SEC was quoted as stating that stock-option backdating "represents the ultimate in greed." Further, Levitt stated: "It is stealing, in effect. It is ripping off shareholders in an unconscionable way." San Diego analyst Michael Cohen later made similar comments published by *Bloomberg*: "Stockholders are hit twice ... first you're stolen from, then the stock goes down when the theft is uncovered." Senator Chuck Grassley, Chairman of the Senate Finance Committee, concurs. He referred to stock-option backdating as "disgusting and repulsive." Grassley stated: "It is behavior that ignores the concept of an 'honest day's work for an honest day's pay' and replaces it with a phrase that we hear all too often today, 'I'm going to get mine.' Even worse in this situation, most of the perpetrators had already gotten 'theirs' in the form of six and seven-figure compensation packages of which most working Americans can only dream."

78. On May 5, 2006, President George W. Bush stated in an interview on the *Kudlow & Company* show airing on CNBC that "overcompensating or trying to backdate things is bad for America and there ought to be consequences when people don't tell the truth and are not transparent."

79. On July 20, 2006, the SEC announced it had filed civil charges against two former Brocade Communications Systems, Inc. executives for illegally manipulating stock option grant

1 dates. Criminal charges were brought simultaneously, indicating the serious view taken by  
2 governmental agencies with respect to improperly backdated options.

3 80. In a news conference detailing the charges, SEC Chairman Christopher Cox  
4 proclaimed that "the full weight of the federal government is being put behind this effort to stamp  
5 out fraudulent stock option backdating." He disclosed that additional cases likely would be brought  
6 in the "coming weeks and months." In later testimony before a Senate committee, Christopher Cox  
7 indicated that the SEC is currently investigating more than 100 companies, a large percentage of  
8 which are tech companies, meaning many more executives could face criminal charges related to  
9 manipulating options.

10 81. Government disgust at stock-option backdating reached a new level on July 31, 2006,  
11 when the FBI issued an arrest warrant for Kobi Alexander ("Alexander") – former CEO of Comverse  
12 Technology, Inc. ("Comverse"). Alexander was charged with conspiracy related to backdated stock  
13 options. Not surprisingly, on August 9, 2006, he and fellow company cohorts David Kreinberg  
14 ("Kreinberg") (former CFO of Comverse) and William F. Sorin ("Sorin") (Comverse's former  
15 General Counsel) were criminally charged by the New York U.S. Attorney's Office for allegedly  
16 orchestrating a decade-old scheme to fraudulently backdate option grants and for operating a secret  
17 stock options slush fund. After transferring more than \$57 million from the U.S. to accounts in the  
18 Middle East, Alexander fled the country.

19 82. Emphasizing the importance that the U.S. government has placed on dealing with the  
20 backdating options scandal, Alexander was placed on the FBI's most wanted list. On  
21 September 27, 2006, after an international manhunt, Alexander was captured in Namibia, and is  
22 expected to be extradited to the U.S. to stand trial with his alleged co-conspirators Kreinberg and  
23 Sorin. On October 24, 2006, Kreinberg (Comverse's former CFO) pled guilty to securities fraud  
24 charges in federal court, and faces up to 15 years in prison. He was reportedly the first person to  
25 plead guilty in the widening stock option backdating scandal.

26 83. Also, on October 24, 2006, Kreinberg agreed to settle SEC charges for \$2.4 million in  
27 disgorgement and interest and is permanently barred from serving as an officer or director of any  
28 company that has a class of securities registered pursuant to §12 of the Securities Exchange Act of

1 1934 (the "Exchange Act") or that is required to file reports pursuant to §15(d) of the Exchange Act.  
2 Shortly thereafter, on November 6, 2006, Sorin (Comverse's former General Counsel) pled guilty to  
3 a federal criminal conspiracy charge related to the backdating scheme at Comverse. The charge  
4 carries a maximum penalty of five years in prison. Kreinberg and Sorin are the first two executives  
5 succumbing to criminal charges in the widening backdating scandal, which now encompasses well  
6 over 100 companies under investigation by the SEC.

7 84. On August 7, 2007, Gregory Reyes ("Reyes"), CEO of Brocade Communications  
8 Systems, Inc., became the first executive to be convicted of fraud in connection with options  
9 backdating. Reyes' conviction shows that juries consider illegal options backdating to be a crime  
10 deserving of jail time. Reyes currently faces up to 20 years in prison and a \$5 million fine.

11 **DEFENDANTS' ILLEGAL OPTIONS MANIPULATING PRACTICES**

12 85. Dating back to at least 1999, the Individual Defendants have caused or allowed Blue  
13 Coat insiders to manipulate their stock option grant dates so as to illegally maximize their profits  
14 from the stock options. Specifically, Company insiders cherry-picked their respective stock option  
15 grant dates to take advantage of lower exercise prices than the price on the actual grant date. The  
16 price of Blue Coat shares on the reported option-grant date, therefore, was lower than the share price  
17 on the actual day the options were issued, thus providing defendants with more favorably priced  
18 options. The Blue Coat Board, in turn, approved the grants of the options to Blue Coat insiders even  
19 though those options were improperly manipulated.

20 86. Plaintiffs undertook a systematic, thorough analysis to determine whether any grants  
21 of Blue Coat stock options could be characterized as "suspicious" – *i.e.*, whether a stock option  
22 demonstrated a significant probability that its grant date was selected as a result of backdating or  
23 springloading by one or more Individual Defendants.

24 87. First, plaintiffs analyzed Blue Coat's stock price movement within a three-month  
25 window around each option grant to determine if any grants were dated at or relatively near the  
26 Company's lowest share price for the month, quarter or year in which it was granted. Plaintiffs then  
27 selected an initial pool of stock options for further analysis based upon those options carrying a  
28



1 purported grant date that occurred either in close proximity to the lowest share price of the month, or  
2 shortly before a substantial increase in price of the Company's stock.

3 88. Next, plaintiffs determined if the grants in the initial pool could be explained by non-  
4 suspicious circumstances. Examples of such circumstances include: (i) options granted in  
5 conjunction with an annual meeting; (ii) options granted under stock option plans that provide for  
6 automatic option grants on a particular date each year; (iii) options of which the recipient disclosed  
7 the grant within a few days of the grant; and (iv) options that appeared to be consistently granted at  
8 the same time each year to take advantage of readily-foreseeable, historic dips in Blue Coat's stock  
9 price.

10 89. After eliminating option grants encompassed by such circumstances, plaintiffs  
11 conducted further analysis to determine if an overall pattern of suspicious option granting existed  
12 over a particular time period, and then to define that period. In particular, plaintiffs compared the  
13 Options Recipient Defendants' returns to the returns of a typical Blue Coat investor to determine if  
14 such defendants enjoyed a return that was significantly in excess of the returns experienced by the  
15 average non-insider investor from the general public. Plaintiffs also conducted a probability  
16 analysis, further described below, to determine the overall probability that the pattern of suspicious  
17 option grants occurred strictly by chance. Plaintiffs' analysis also took into account Blue Coat's  
18 publicly-filed disclosures relative to the manipulation of Company stock options that were never  
19 before disclosed in public filings.

20 90. Based upon this analysis and Blue Coat's public filings, plaintiffs found a suspicious  
21 pattern of stock option manipulation that occurred between 1999 and August 2005. The eventual  
22 disclosure of underlying documentation for all Blue Coat stock options granted during the Relevant  
23 Period may well disclose a much greater breadth of illicit activity. The following grants are the  
24 grants that plaintiffs selected as suspicious of options manipulation:

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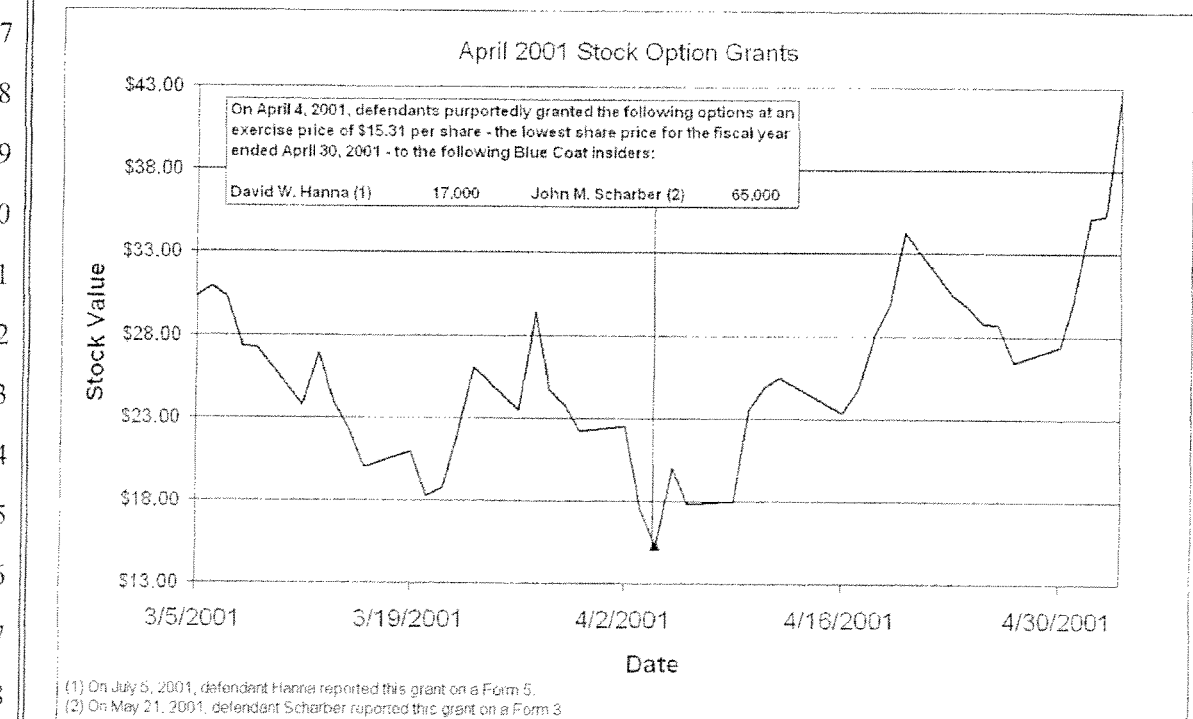
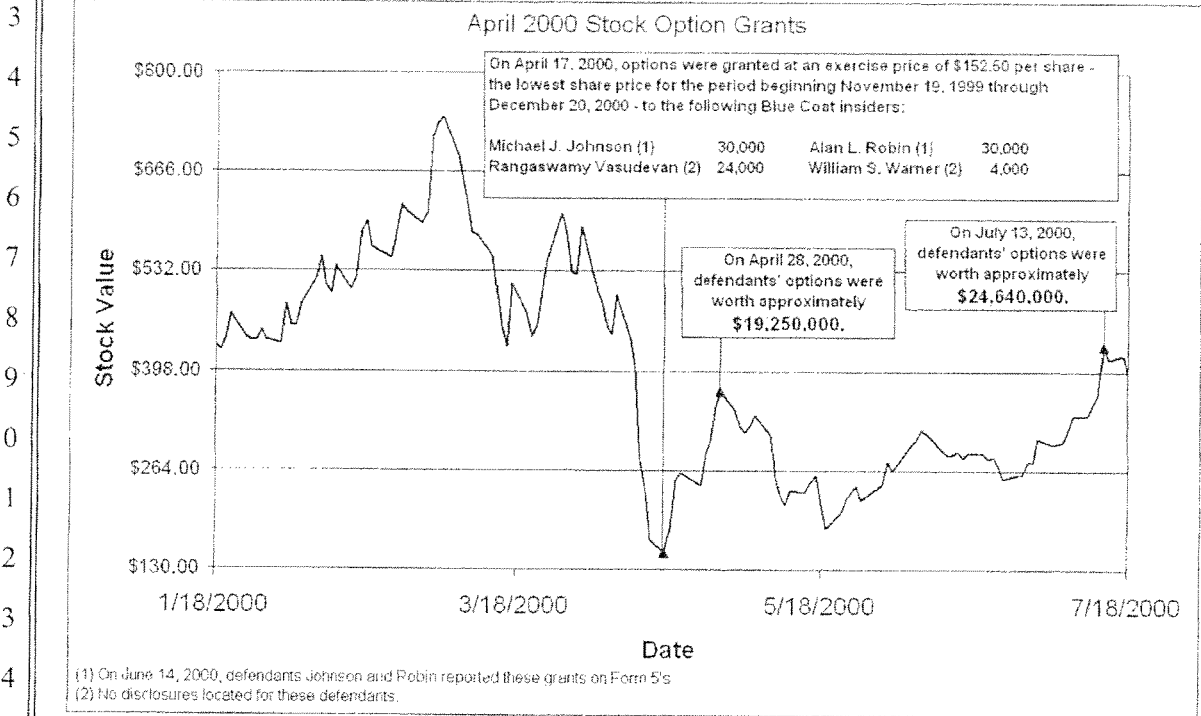
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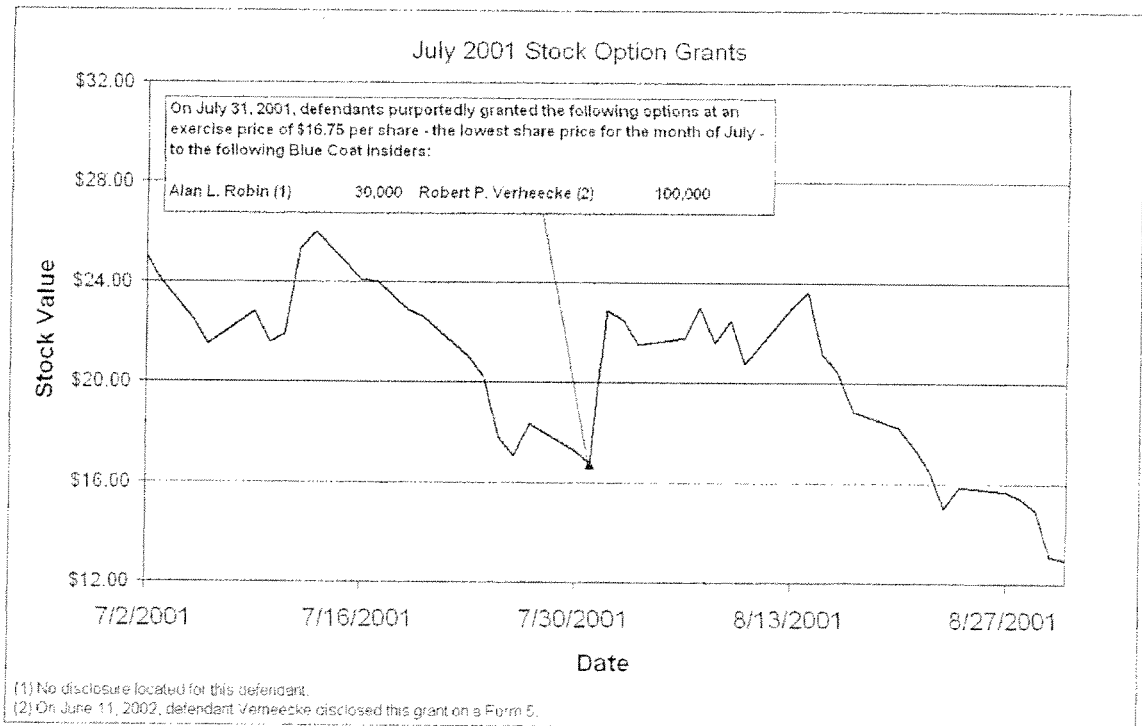
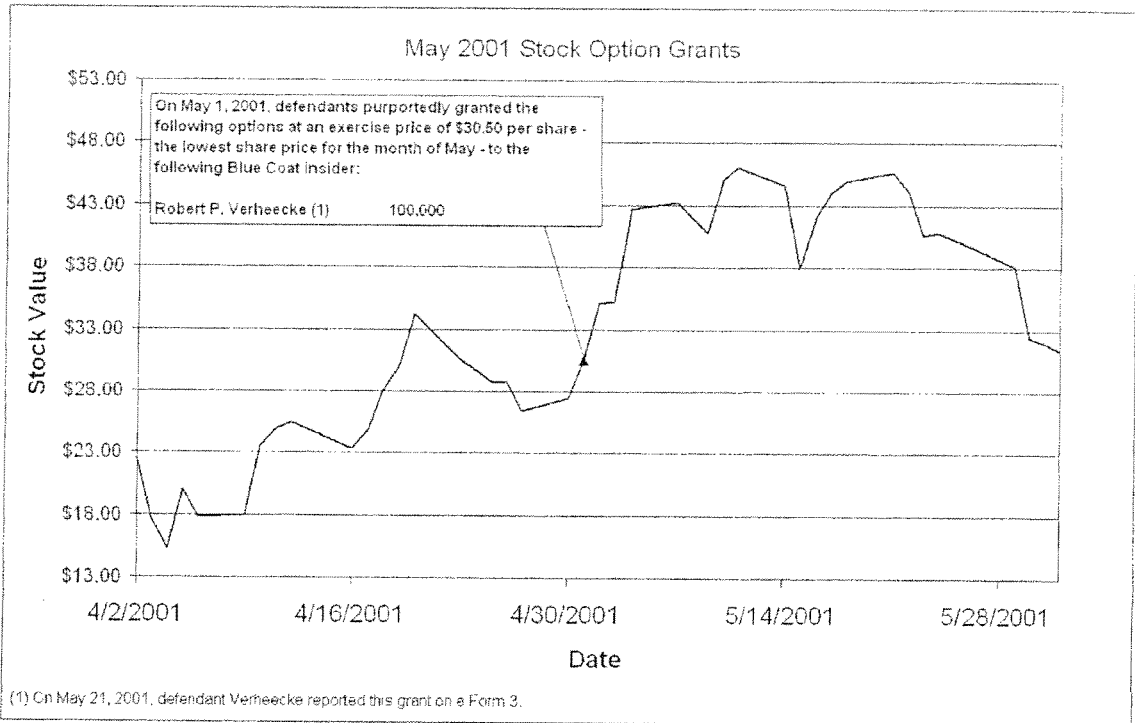
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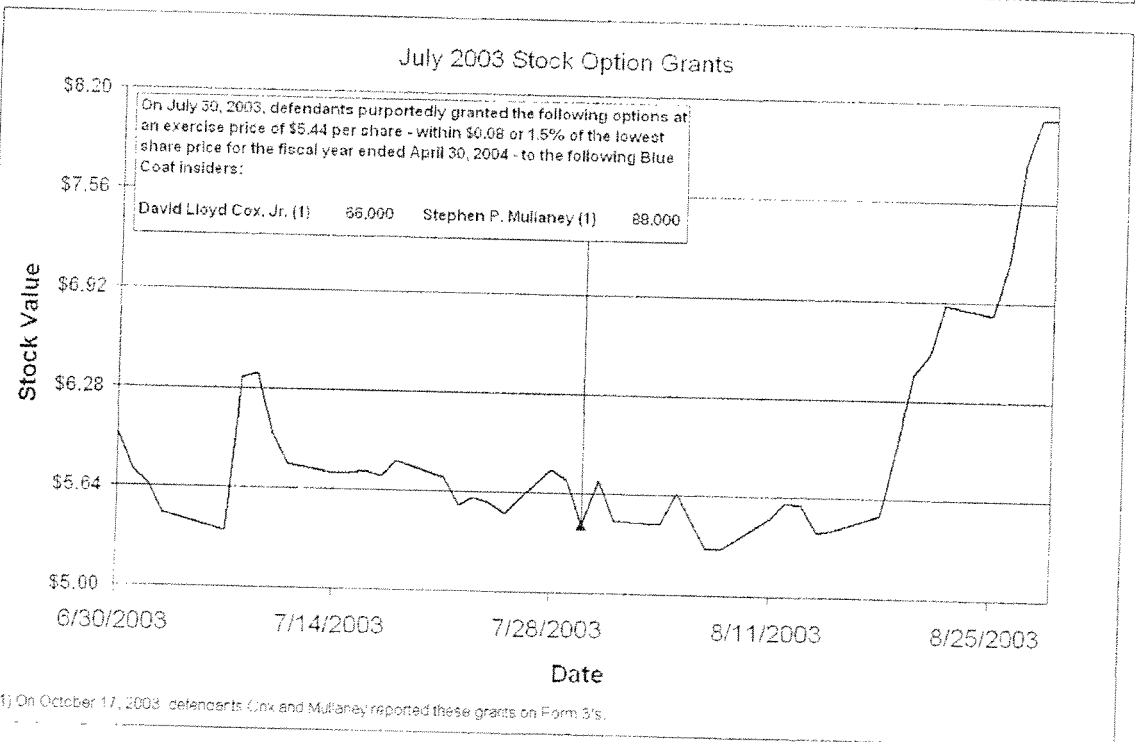
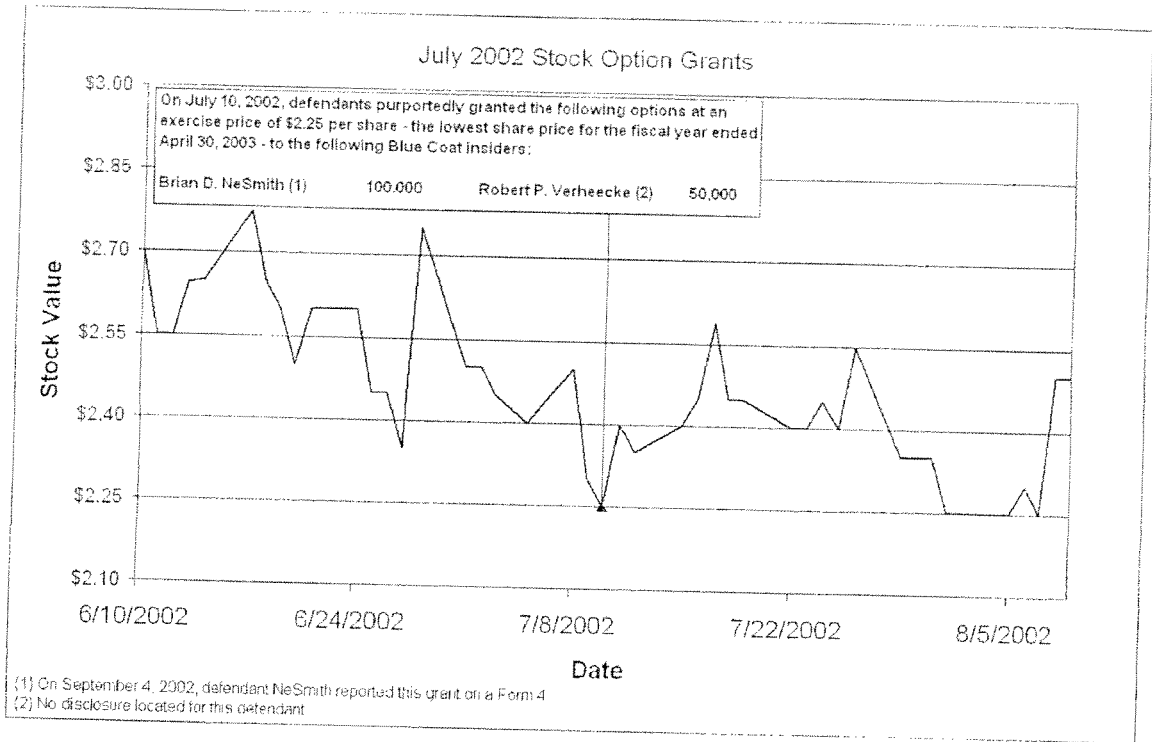
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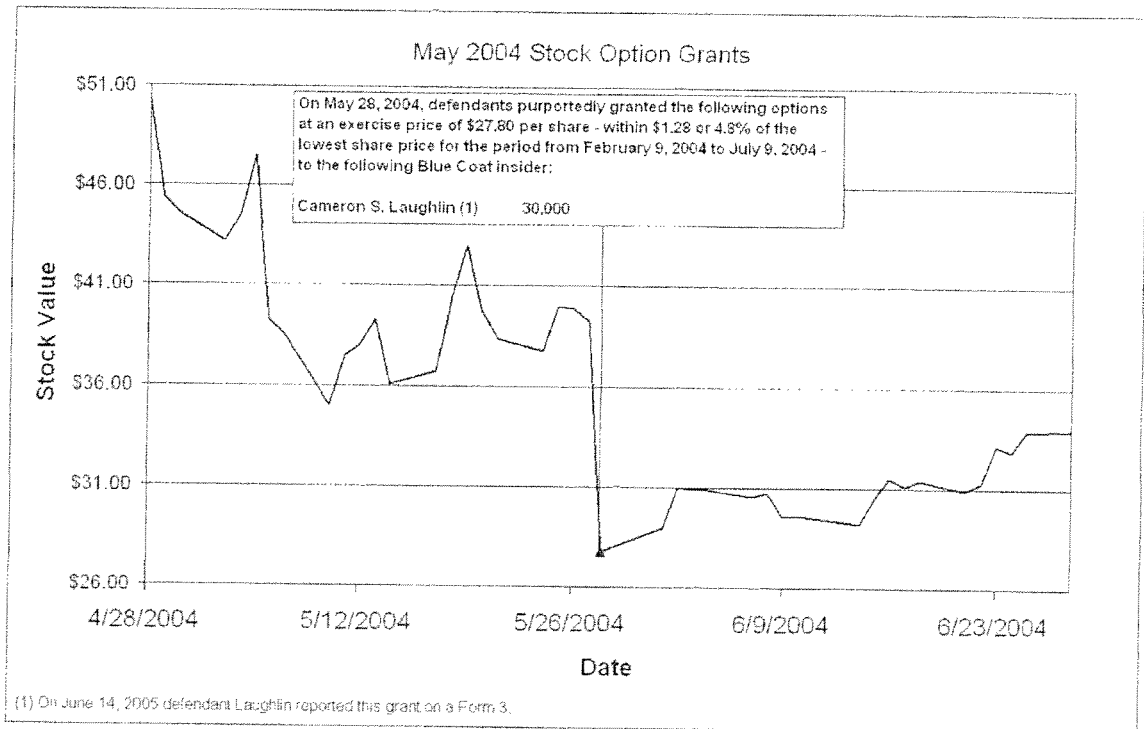
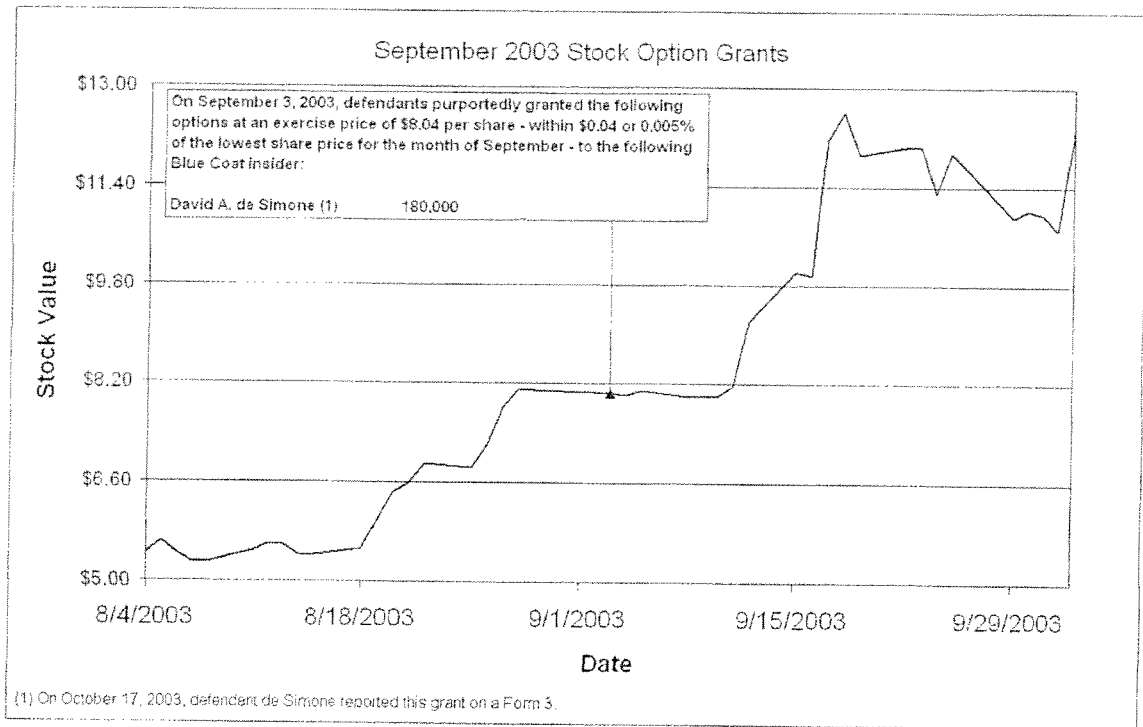
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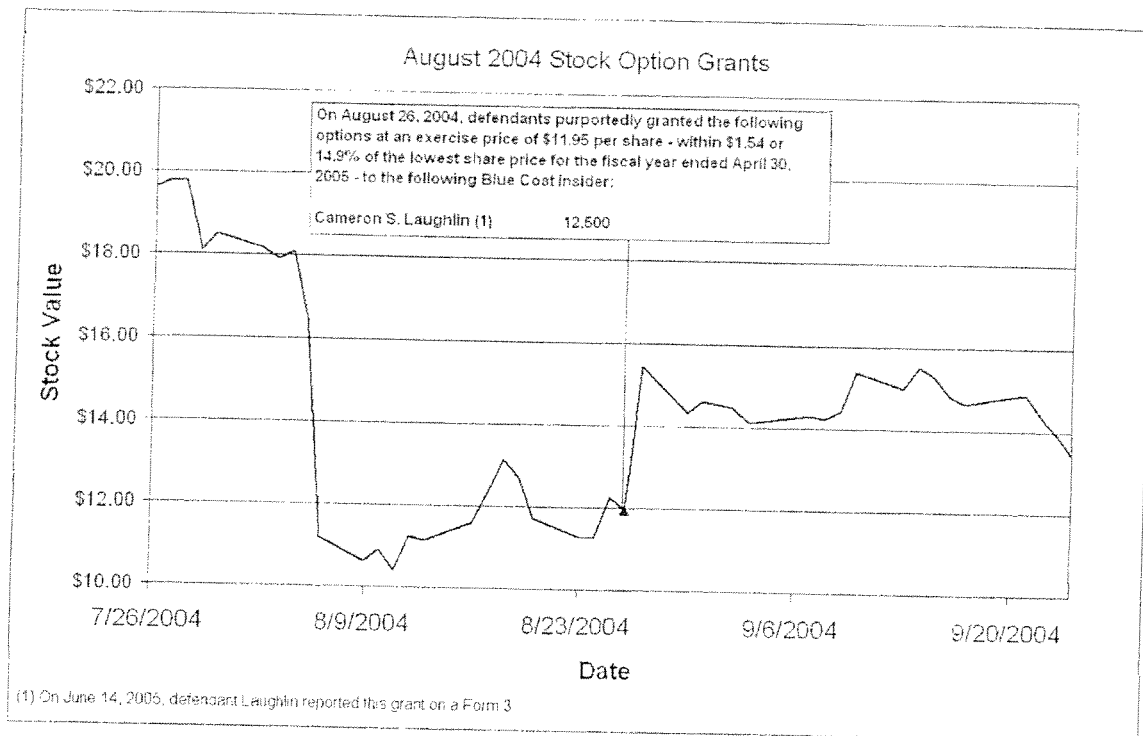
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91. The following table provides an estimate as to the illegal paper profit that the defendants identified in the prior charts gained as a result of their stock option manipulations:

Defendants	Reported Grant Date	Adjusted Number of Securities Underlying Options	Adjusted Price of Stock on Reported Date	Estimated Actual Exercise Price Range			Estimated Paper Profit Average
				Low		High	
Johnson	4/17/2000	30,000	\$152.50	\$185.31	-	\$371.25	\$3,838,500.00
Robin	4/17/2000	30,000	\$152.50	\$185.31	-	\$371.25	\$3,838,500.00
Vasudevan	4/17/2000	24,000	\$152.50	\$185.31	-	\$371.25	\$3,070,800.00
Warner	4/17/2000	4,000	\$152.50	\$185.31	-	\$371.25	\$511,800.00
Hanna	4/4/2001	17,000	\$15.31	\$17.81	-	\$42.65	\$213,520.00
Scharber	4/4/2001	65,000	\$15.31	\$17.81	-	\$42.65	\$816,400.00
Verheecke	5/1/2001	100,000	\$30.50	\$31.40	-	\$46.05	\$991,000.00
Robin	7/31/2001	30,000	\$16.75	\$17.45	-	\$23.65	\$69,660.00
Verheecke	7/31/2001	100,000	\$16.75	\$18.45	-	\$23.65	\$232,200.00
NeSmith	7/10/2002	100,000	\$2.25	\$2.35	-	\$2.59	\$14,000.00
Verheecke	7/10/2002	50,000	\$2.25	\$2.35	-	\$2.59	\$7,000.00
Cox	7/30/2003	66,000	\$5.44	\$5.45	-	\$8.10	\$47,038.20
Mullaney	7/30/2003	88,000	\$5.44	\$5.45	-	\$8.10	\$62,480.00
de Simone	9/3/2003	180,000	\$8.04	\$8.10	-	\$12.60	\$427,320.00
Laughlin	5/28/2004	30,000	\$27.80	\$28.96	-	\$33.95	\$100,547.40
Laughlin	8/26/2004	12,500	\$11.95	\$13.44	-	\$15.51	\$33,500.00
<b>Total</b>		<b>926,500</b>					<b>\$14,274,265.60</b>

92. The following charts compare the returns on stock options realized by defendants to the returns realized by average Blue Coat investors for suspicious and non-suspicious grants from April 2000 to the present. The "Defendant Option Grant Date" column lists the various dates on which Blue Coat insiders were granted suspiciously-dated stock options. The "Defendant 20-Day Return" column shows the return realized by Blue Coat insiders in the twenty days following the option grant date. This amount is compared to the "Investor Average 20-Day Return" column, which lists the average return realized by average Blue Coat investors over a typical twenty-day period in the year of the grant date. The percentage difference between these two returns is shown in the "Defendant Excess Return" column. A May 22, 2006 report by Merrill Lynch entitled *Options Pricing - Hindsight is 20/20* stated: "Theoretically, companies should not be generating any systematic excess return in comparison to other investors as a result of how options pricing events are timed." Conversely, suspiciously dated option grants by Blue Coat did generate large excess returns in comparison to grants not suspiciously dated, thereby strongly suggesting the occurrence of grant date manipulation.

#### Suspicious Grants

Defendant Option Grant Date	Defendant 20-Day Return	Investor Average 20-Day Return	Defendant Excess Return	Defendant Annualized Return	Investor Annual Return	Defendant Excess Return
4/17/2000	53.69%	-4.76%	58.46%	979.88%	-86.94%	1066.82%
4/4/2001	129.26%	-4.62%	133.88%	2359.03%	-84.29%	2443.32%
5/1/2001	24.75%	-4.62%	29.37%	451.76%	-84.29%	536.06%
7/31/2001	-6.57%	-4.62%	-1.95%	-119.85%	-84.29%	-35.56%
7/10/2002	2.22%	-3.87%	6.09%	40.56%	-70.67%	111.23%
7/30/2003	32.35%	25.63%	6.73%	590.44%	467.68%	122.76%
9/3/2003	37.19%	25.63%	11.56%	678.70%	467.68%	211.02%
2/4/2004	97.82%	-0.91%	98.73%	1785.16%	-16.58%	1801.74%
5/28/2004	22.12%	-0.91%	23.03%	403.73%	-16.58%	420.32%
8/26/2004	16.74%	-0.91%	17.65%	305.44%	-16.58%	322.02%
5/2/2005	31.87%	7.98%	23.89%	581.69%	145.67%	436.02%
8/16/2005	40.11%	7.98%	32.13%	732.05%	145.67%	586.38%
<b>Average:</b>	<b>40.13%</b>	<b>3.50%</b>	<b>36.63%</b>	<b>732.38%</b>	<b>63.87%</b>	<b>668.51%</b>

## Other Grants

Insider Option Grant Date	Insider 20-Day Return	Investor Average 20-Day Return	Insider Excess Return	Insider Annualized Return	Investor Annual Return	Insider Excess Return
8/30/2000	48.10%	-4.76%	52.86%	877.74%	-86.94%	964.68%
12/29/2000	7.60%	-4.76%	12.36%	138.71%	-86.94%	225.66%
8/29/2001	-57.05%	-4.62%	52.43%	-1041.11%	-84.29%	956.81%
9/12/2002	5.07%	-3.87%	8.95%	92.61%	-70.67%	163.28%
10/9/2002	2.38%	-3.87%	6.25%	43.45%	-70.67%	114.12%
11/20/2002	-17.29%	-3.87%	13.42%	-315.60%	-70.67%	244.93%
6/17/2003	2.68%	25.63%	22.95%	48.88%	467.68%	418.80%
10/7/2003	27.17%	25.63%	1.54%	495.86%	467.68%	28.18%
11/28/2003	9.49%	25.63%	16.14%	173.14%	467.68%	294.54%
5/14/2004	-19.09%	-0.91%	18.18%	-348.41%	-16.58%	331.83%
10/5/2004	3.59%	-0.91%	4.50%	65.57%	-16.58%	82.15%
1/14/2005	20.48%	7.98%	12.50%	373.80%	145.67%	228.12%
5/23/2005	47.40%	7.98%	39.42%	865.06%	145.67%	719.38%
7/18/2005	3.23%	7.98%	-4.75%	58.95%	145.67%	-86.72%
9/20/2005	-2.17%	7.98%	10.15%	-39.53%	145.67%	185.21%
11/14/2005	-13.81%	7.98%	21.79%	-251.99%	145.67%	397.66%
6/22/2006	-8.15%	-2.61%	-5.54%	-148.73%	-47.62%	101.11%
6/27/2006	-13.32%	-2.61%	10.71%	-243.11%	-47.62%	195.49%
12/28/2006	4.91%	-2.61%	7.52%	89.65%	-47.62%	137.27%
12/29/2006	4.18%	-2.61%	6.78%	76.20%	-47.62%	123.82%
3/14/2007	-2.45%	7.23%	-9.68%	-44.79%	131.86%	176.65%
4/19/2007	10.10%	7.23%	2.87%	184.32%	131.86%	52.46%
4/30/2007	11.52%	7.23%	4.30%	210.30%	131.86%	78.44%
6/21/2007	13.00%	7.23%	5.78%	237.32%	131.86%	105.46%
<b>Average:</b>	<b>3.65%</b>	<b>4.49%</b>	<b>-0.84%</b>	<b>66.60%</b>	<b>81.88%</b>	<b>-15.28%</b>

93. Plaintiffs' analysis identified a total of 36 option grants by Blue Coat from 1999 to the present. Plaintiffs concluded that twelve of these grants appeared to be subject to purposeful grant date manipulation. The table below ranks the twelve manipulated grants according to the grant price selected for the month; *i.e.*, a "1" ranking indicates an option grant set at the lowest closing share price for that month. The table also sets forth the percentage returns for Blue Coat stock during the twenty days after the respective grant date. As shown below, the twenty-day stock return for the ten manipulated option grants averaged over 43 percent. In comparison, the other 26 grant dates were



1 followed by an average twenty-day stock return of 5.46 percent. Of the manipulated grants, nine  
 2 were granted on the lowest day of their respective months. The Options Recipient Defendants'  
 3 excessive returns from these grants as well as the low monthly ranking of these grants—nine were  
 4 ranked at the lowest closing share price of the month—strongly infer that these particular grants  
 5 were manipulated.

#### Suspicious Grants

Grant Date	Monthly Rank	20 Day Return
4/17/2000	1	53.69%
4/4/2001	1	129.26%
5/1/2001	1	24.75%
7/31/2001	1	-6.6%
7/10/2002	1	2.22%
2/4/2004	1	97.82%
5/28/2004	1	22.1%
5/2/2005	1	31.87%
8/16/2005	1	47.40%
7/30/2003	2	32.4%
9/3/2003	5	37.2%
8/26/2004	11	16.74%

Average: 40.74%

#### Other Grants

Grant Date	Monthly Rank	20 Day Return
12/29/2000	1	7.6%
4/30/2007	1	11.5%
12/29/2006	2	4.2%
8/29/2001	3	-57.0%
6/17/2003	3	2.7%
7/18/2005	3	3.2%
4/19/2007	3	10.1%
10/7/2003	4	27.2%
5/14/2004	4	-19.1%
12/28/2006	4	4.9%
9/12/2002	6	5.1%
6/22/2006	6	-8.1%
10/9/2002	9	2.4%
1/14/2005	9	20.48%
10/5/2004	10	3.6%
3/14/2007	10	-2.5%
5/23/2005	12	47.40%
11/20/2002	14	-17.3%
6/27/2006	18	-13.3%
11/28/2003	19	9.5%

9/20/2005	20	-2.2%
11/14/2005	20	-13.8%
6/21/2007	20	13.0%
8/30/2000	21	48.1%

**Average: 3.65%**

94. The probability that the overall pattern of options grants described above was subject to options manipulation can be illustrated by a binomial experiment. Binomial experiments involve repeating an event that only has two possible outcomes over and over again to create a particular set of results known as a "distribution." For example, flipping a coin 10 times to see how many times "heads" comes up would qualify as a binomial experiment. A mathematical formula is then used to determine the probability of a particular distribution being repeated. Continuing with the coin flip analogy, the probability that one could repeatedly get a binomial distribution of all heads is rather rare.

95. Applying this analysis to stock options involves assuming two outcomes for a particular options grant: either the grant occurred on a day during a particular time period at which the Company's stock price was at its lowest point for that period, or it was not. Plaintiffs undertook a binomial analysis with this assumption by: (i) determining the total number of stock options grants that were granted between 2000 and 2005, which corresponds with the time period during which plaintiffs suspect that backdating occurred at Blue Coat; (ii) determining how many times options were granted at the lowest stock price for a 20-day trading period during the month in which the option was granted; (iii) computing the probability of choosing the lowest price during this 20-day period by chance, which is one in 20 or 5%; and (iv) entering the foregoing figures into a binomial formula regularly used by statisticians. That binomial formula is as follows:

$$P = \frac{n!}{k!(n-k)!} p^k q^{n-k}$$

Where:

n = total number of option grants

k = number of times that the Individual Defendants dated stock options on day reflecting the lowest Blue Coat stock price in a 20 day period

p = probability of selecting the lowest day of the month by chance

q = probability of not selecting the lowest day of the month by chance

P = the overall probability that the option grants distribution occurred by chance

96. Plaintiffs used the following values to calculate the probability that the Individual Defendants' stock option grant distribution occurred by chance:  $n=28$ ,  $k=10$ ,  $p=.05$ ,  $q=.95$ .

97. Here is the calculation that results from inserting the above-described figures into the formula:

$$P = \frac{28(.05^{10})(.95^{28-10})}{9(28-10)} \rightarrow P = 5.09051^{-7} \text{ or } \underline{1 \text{ in } 1,964,438} (1/5.09051^{-7})$$

98. In sum, the binomial probability that the pattern of the Options Recipient Defendants' option grants occurred strictly by chance is ***one in 1,964,438***. In comparison, the odds of being struck by lightning are a mere one in 30,000.

99. The table below is a summary of the underlying data used to calculate this probability:

Quarter Ended	Options Grant Date	Number of Shares in Grant	Options Strike Price	Monthly Low Price	Monthly Rank
April 30, 2000	April 17, 2000	88,000	\$152.50	\$152.50	1
October 31, 2000	August 30, 2000	4,000	\$525.00	\$319.69	19
January 31, 2001	December 29, 2000	20,000	\$85.31	\$85.31	1
April 30, 2001	April 4, 2001	82,000	\$15.31	\$15.31	1
July 31, 2001	May 1, 2001	100,000	\$30.50	\$30.50	1
July 31, 2001	July 31, 2001	130,000	\$16.75	\$16.75	1
October 31, 2001	August 29, 2001	3,000	\$14.90	\$12.95	3
July 31, 2002	July 10, 2002	150,000	\$2.25	\$2.25	1
October 31, 2002	September 12, 2002	4,000	\$3.35	\$3.15	5
October 31, 2002	October 9, 2002	24,500	\$3.52	\$3.12	9
January 31, 2003	November 20, 2002	66,000	\$3.99	\$3.47	18
July 31, 2003	June 17, 2003	50,000	\$5.60	\$5.51	4
July 31, 2003	July 30, 2003	154,000	\$5.44	\$5.36	2
October 31, 2003	September 3, 2003	180,000	\$8.04	\$8.00	5
October 31, 2003	October 7, 2003	11,250	\$13.36	\$10.70	4
January 31, 2004	November 28, 2003	100,000	\$20.87	\$14.81	19
April 30, 2004	February 4, 2004	25,000	\$21.53	\$21.53	1
July 31, 2004	May 14, 2004	5,000	\$36.09	\$27.80	3
July 31, 2004	May 28, 2004	30,000	\$27.80	\$27.80	1
October 31, 2004	August 26, 2004	12,500	\$11.95	\$10.41	11
October 31, 2004	October 5, 2004	13,750	\$16.70	\$14.81	10
January 31, 2005	January 14, 2005	17,500	\$19.09	\$17.63	9
July 31, 2005	May 2, 2005	75,000	\$13.93	\$13.93	1
July 31, 2005	May 23, 2005	84,200	\$18.08	\$13.93	12
July 31, 2005	July 18, 2005	3,500	\$30.03	\$29.87	3
October 31, 2005	August 16, 2005	10,000	\$30.24	\$30.24	1
October 31, 2005	September 20, 2005	13,000	\$42.47	\$39.12	20

January 31, 2006	November 14, 2005	10,000	\$52.00	\$39.53	20
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100. To put this analysis in context, plaintiffs conducted a second analysis of Blue Coats' options granted during 2006 and 2007: a period during which plaintiffs suspect that options manipulation did not occur. The result of that analysis was a probability of approximately one in three and a half. Here is the calculation that supplied this result:

$$P = \frac{8(.05^{10})(.95^{8-1})}{1(8-1)} \rightarrow P = 0.279334 \text{ or } \underline{1 \text{ in } 3.5799} (1/0.279334)$$

101. The table below is a summary of the underlying data used to calculate this probability:

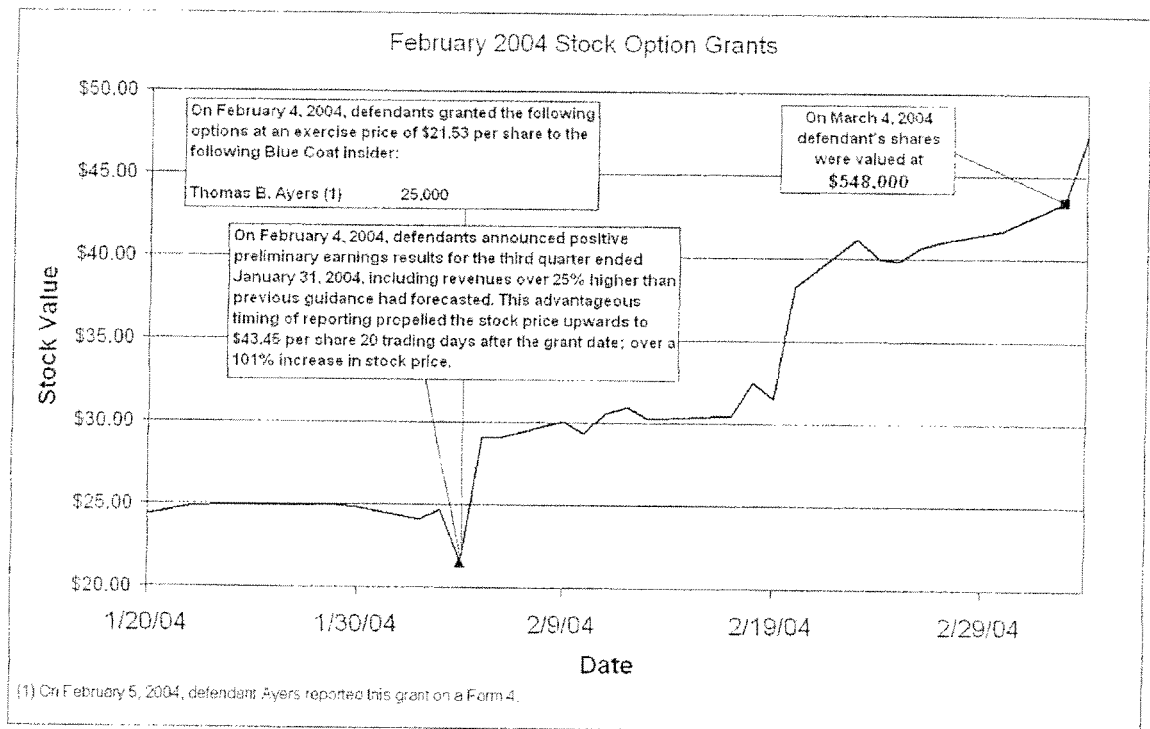
Quarter Ended	Options Grant Date	Number of Shares in Grant	Options Strike Price	Monthly Low Price	Monthly Rank
July 31, 2007	June 22, 2006	10,000	\$14.97	\$14.66	6
July 31, 2007	June 27, 2006	5,000	\$16.70	\$14.66	20
January 31, 2007	December 28, 2006	98,876	\$24.02	\$23.83	4
January 31, 2007	December 29, 2006	242,357	\$23.95	\$23.83	2
April 30, 2007	March 14, 2007	95,124	\$36.67	\$31.57	10
April 30, 2007	April 19, 2007	85,400	\$35.15	\$35.06	4
April 30, 2007	April 30, 2007	49,825	\$35.06	\$35.06	1
July 31, 2007	June 21, 2007	96,250	\$49.14	\$41.96	20

102. An inference that the Options Recipient Defendants' option grants were manipulated is further supported by the fact that these defendants regularly delayed the disclosure of their option grants even after the enactment of SOX. SOX requires options recipients to disclose their option grants within two business days of the grant date. Nevertheless, defendant de Simone did not disclose his September 3, 2003 options grant until October 17, 2003 – more than a month later. Even worse, defendant Laughlin did not disclose his August 16, 2004 options grant until June 14, 2005 – more than *nine months later*.

#### DEFENDANTS' ILLEGAL SPRINGLOADING OPTIONS MANIPULATIONS

103. Springloading is a type of stock option manipulation that involves the illegal misappropriation of inside information so that options are granted shortly before a significant increase in the price of the Company's shares. As with backdating, springloading brings an immediate paper profit to the option recipients.

104. On February 4, 2004, defendants purportedly granted 25,000 options to defendant Ayers. On that same day, Blue Coat announced its earnings for the fiscal quarter ended January 31, 2004. For the quarter, revenues exceeded Blue Coat's guidance by 25%. This positive news precipitated a 101% increase in Blue Coat's share price over the following 20 days. By March 4, 2004, defendant Ayers' shares were worth more than \$78,000. Ayers' option grant is illustrated by the following chart:



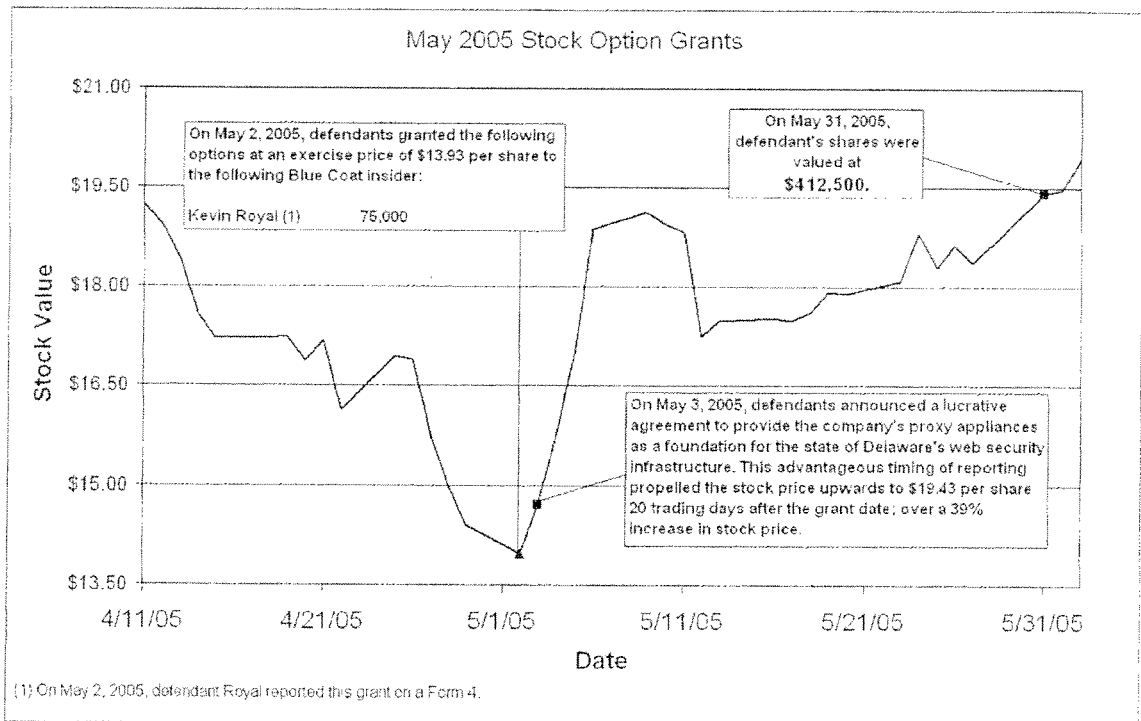
105. On May 2, 2005, defendants purportedly granted 75,000 options to defendant Royal. The next day, Blue Coat announced that it had signed a lucrative contract with the state of Delaware. On this positive news, Blue Coat's share price appreciated 39% over the following 20 days. By May 31, 2005, defendant Royal's grants were worth more than \$412,500. Royal's option grants are illustrated by the following chart:

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106. On August 16, 2005, defendants purportedly granted 10,000 options to defendant Ayers. On that same day, Blue Coat announced its earnings results for the fiscal quarter ended July 31, 2005. For the quarter, Blue Coat reported earnings that were 58% higher than the same quarter in the previous year. On this positive news, Blue Coat's share price appreciated 36% over the following 20 days. By September 14, 2005, these defendants' option grants were worth more than \$109,500. This option grant is illustrated by the following chart:

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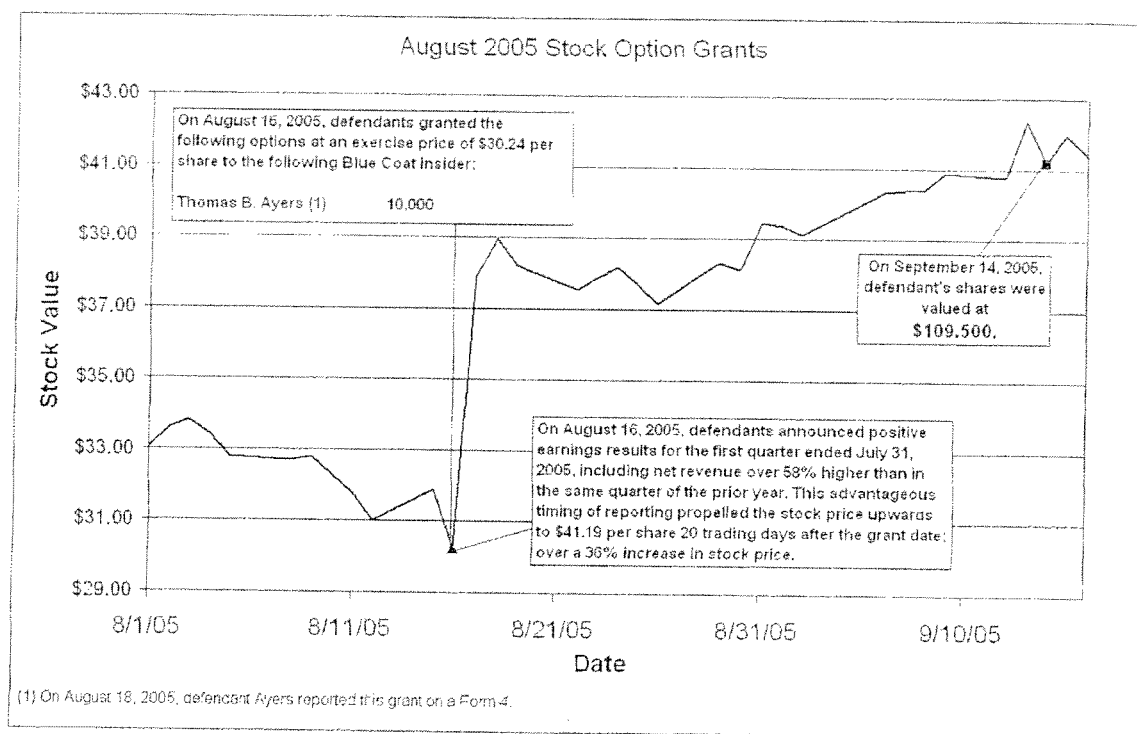
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107. The manipulated option grants described in the preceding paragraphs arose out of the misappropriation of materially-positive, non-public information concerning Blue Coat's financial results and business prospects. Further, defendants issued the springloaded options with the intent to circumvent the Plans, which required that Blue Coat options be granted at not less than fair market value in the case of incentive stock options and at not less than 25% of fair market value in the case of certain non-statutory stock options. Defendants authorized the springloaded grants at times at which they knew that the option exercise price did not accurately reflect the fair market value of Blue Coat's stock due to the unannounced positive material information. Accordingly, defendants' approval, authorization and/or receipt of springloaded options constituted breaches of their fiduciary duties of loyalty and good faith.

108. Further, defendants' springloading practices are equivalent to insider trading in that they utilized material, non-public information to secretly enrich themselves in breach of their fiduciary duties owed to Blue Coat.

1 **THE TRUTH COMES TO LIGHT REGARDING DEFENDANTS' ILLEGAL OPTIONS**  
2 **MANIPULATION PRACTICES**

3 109. On July 14, 2006, Blue Coat announced for the first time that it was conducting an  
4 investigation of its prior options grant practices dating back to the Company's initial public offering  
5 in November 1999. Blue Coat also announced that the investigation had determined that "actual  
6 measurement dates for financial accounting purposes of certain stock option grants issued in the past  
7 *likely differ* from the recorded grant dates of such awards."

8 110. On August 1, 2006, Blue Coat announced that the SEC was conducting its *own*  
9 investigation of Blue Coat's prior options grant practices.

10 111. On September 11, 2006, Blue Coat announced a restatement of its prior financial  
11 statements for fiscal years 2000 through 2005 and interim fiscal 2006 periods. This restatement  
12 became necessary because the internal investigation found that "the actual measurement dates for  
13 financial accounting purposes of certain stock options granted primarily during fiscal years 2000-  
14 2004 *differ* from the recorded grant dates of such awards." The recording of correct grant dates for  
15 Blue Coat's prior options grants resulted in additional material compensation expenses, which must  
16 be disclosed in Blue Coat's financial statements.

17 112. On March 28, 2007, Blue Coat filed its restatement. The restatement includes a \$49  
18 million net income reduction for fiscal 2000 through 2006.

19 113. On that same day, Blue Coat also disclosed the findings of its internal investigation.  
20 Most disturbingly, the investigation found that "*nearly all* of [Blue Coat's] stock options granted  
21 since November 18, 1999 were subject to revised measurement dates." Moreover, "[i]n almost  
22 every such instance, the price of [Blue Coat's] Common Stock on the actual approval date for the  
23 grant was higher than the price of [Blue Coat's] Common Stock on the stated grant date." Blue Coat  
24 disclosed further that undisclosed members of management selected grant dates "with the benefit of  
25 hindsight based on perceived historical lows of [Blue Coat's] stock price."

26 114. According to Blue Coat's disclosures, the Company improperly accounted for stock  
27 options granted between November 1999 and May 2006. Further, the Compensation Committee was  
28 responsible for granting the majority of the Company's stock options during this period. In a few



1 instances, however, the entire Board granted stock options. Moreover, the investigation determined  
2 that the Compensation Committee and Board regularly used faxed unanimous written consents to  
3 approve option grant dates. The Compensation Committee and Board, however, did not bother to  
4 verify that option grant dates matched the consent dates on the faxes. This policy resulted in "*nearly*  
5 *all*" of Blue Coat's options being improperly dated.

6 115. Blue Coat has admitted that the following internal control deficiencies directly  
7 contributed to the rampant options manipulation:

- 8 • Blue Coat lacked written stock option procedures or the Company's  
9 procedures were generally unresponsive to inherent process risks;
- 10 • Blue Coat's stock option granting practices were haphazard and disorganized.  
11 For example, management frequently submitted stock option grant approval  
12 documentation to the Compensation Committee weeks after the stated grant  
13 date; the Compensation Committee frequently approved two or three  
14 different stock option grants at the same time; and management frequently  
15 added employees to stock option grants after the stated option grant date;
- 16 • The Compensation Committee did not have an adequate knowledge  
17 base to appreciate the accounting and legal implications of options  
18 mis-dating; and
- 19 • The Compensation Committee routinely approved stock option grants  
20 on an "as of" basis and did not inquire into the propriety of  
21 retroactively seeking grant dates.

22 116. Blue Coat also disclosed that on the day before the Company's initial public offering,  
23 on November 18, 1999, the Board granted options at an exercise price of \$120 to a large group of  
24 undisclosed insiders. The internal investigation later determined that ten of those insiders were not  
25 Blue Coat employees at the time of the grant. The investigation also determined that those insiders'  
26 stock option grants should have been priced as of January 24, 2000 when Blue Coat's shares were  
27 trading at \$221.25.

28 117. Further, Blue Coat disclosed conclusions of the special committee that was appointed  
to direct the internal investigation. Specifically, the special committee concluded that defendants  
NeSmith and Hanna, although involved in the options manipulation, were not aware of the  
accounting or legal implications of their actions. Blue Coat, however, did not disclose any specific  
findings supporting these conclusions. Instead, Blue Coat disclosed findings that actually belie these

1 conclusions. For example, the special committee found that NeSmith held *\$2.6 million worth* of  
2 unexercised options subject to improper measurement dates. Hanna held *\$162,520 worth* of options  
3 similarly subject to improper measurement dates. Moreover, the special committee found several  
4 emails addressed to Hanna that "indicated that stock option grant dates and prices were being  
5 selected with the benefit of hindsight." Blue Coat offered no explanation as to how these findings  
6 are consistent with a conclusion that NeSmith and Hanna were not aware of the implications of their  
7 actions.

8 118. The special committee, however, did conclude that defendants Laughlin and  
9 Verheecke were aware that stock options grants were selected with hindsight and that they should  
10 have appreciated the accounting and legal implications of their actions.

11 **IMPROPER FINANCIAL REPORTING RELATING TO DEFENDANTS' STOCK**  
12 **OPTION MANIPULATIONS**

13 119. Between 1999 and the present, the Individual Defendants caused or allowed Blue  
14 Coat to file proxies, Form 10-Qs, Form 10-Ks and other filings that presented the Company's  
15 financial results in violation of Generally Accepted Accounting Principles ("GAAP"), due to  
16 improper accounting for manipulated stock option grants. Specifically, Blue Coat's compensation  
17 expenses were understated and its net earnings were overstated.

18 120. Further, defendants have caused or allowed Blue Coat: (i) to file materially false and  
19 misleading financial statements that materially understated its compensation expenses and materially  
20 overstated its quarterly and annual net income and earnings per share; and (ii) to make disclosures in  
21 its periodic filings and proxy statements that falsely portrayed the Company's stock options as  
22 having been granted at exercise prices equal to the fair market value of Blue Coat's common stock  
23 on the date of the grant. Under GAAP, the instant paper gain received from backdated stock options  
24 was equivalent to paying extra compensation and should have been recorded as a cost to Blue Coat.  
25 These costs also were not properly recorded. In turn, since these costs were not properly recorded,  
26 Blue Coat's profits were materially overstated, which rendered its financial statements for the periods  
27 in question false and misleading.

1 121. Specifically, since 1999, the Individual Defendants have caused or allowed Blue Coat  
2 to report improper financial results—materially overstating its earnings—as follows:

3 Fiscal Year (Ending April 30)	Reported Earnings (in thousands)	Reported Number of Shares (in thousands)	Reported Diluted EPS
4 2000	(\$62,653)	3,787	(\$16.54)
5 2001	(\$519,096)	7,190	(\$72.20)
6 2002	(\$243,624)	8,329	(\$29.25)
7 2003	(\$18,997)	8,777	(\$2.16)
8 2004	(\$5,361)	9,956	(\$0.54)
9 2005	\$4,656	12,908	\$0.36
10 2006	\$2,940	14,642	\$0.20
11 2007	(\$7,198)	14,594	(\$0.49)

12 Splits: 9/16/02 [1:5]

### 13 BLUE COAT'S TAX LIABILITY

14 122. In addition to breaches of fiduciary duty and accounting issues, the manipulation of  
15 stock options can have severely adverse tax consequences. While stock options generally qualify for  
16 favorable tax treatment, options issued at a discount to the market price do not qualify for that  
17 treatment. In effect, backdating allows these "in-the-money" options to appear in regulatory filings  
18 as if they were ordinary "at the-money" grants. For example, for performance-based stock options  
19 (generally granted to the five highest-paid executives), a company is allowed to take a tax deduction  
20 on that full amount *provided that the options were granted at the market price*. Backdating and  
21 other stock options manipulations, however, automatically disqualifies those options from receiving  
the tax break—instead, a company's tax deduction would be capped at \$1 million for each of the top  
five executives.

22 123. In light of these serious potential adverse tax-related ramifications, the IRS is now  
23 examining as many as 40 companies, which are being investigated for manipulating stock options, to  
24 determine whether they owe millions of dollars in unpaid taxes. On July 28, 2006, the *New York*  
25 *Times* published an article entitled "I.R.S. Reviewing Companies in Options Inquiries," which stated:

26 The Internal Revenue Service is examining as many as 40 companies ensnared in  
27 various stock options investigations to determine whether they owe millions of  
28 dollars in unpaid taxes.

1 In the last few weeks, the agency has directed its corporate auditors to start  
2 reviewing the tax returns of dozens of executives and companies, which may have  
3 improperly reported stock option grants. These preliminary investigations are  
4 expected to take months, but if there is early evidence of widespread tax trouble,  
5 I.R.S. officials said they were prepared to step up their effort.

6 "Where there are indications of mischief, we want to now look at those cases  
7 and see if they complied with tax laws," said Bruce Ungar, the agency's deputy  
8 commissioner for large and midsize businesses. "It is possible that they are  
9 compliant, but the early indication is that there is a good likelihood there is some  
10 noncompliance.

11 "If this is a big problem, we will apply more resources," he added.

12 The I.R.S. auditors are focusing on the potential tax obligations from  
13 backdated stock options that have been cashed out since 2002. Federal rules bar the  
14 I.R.S. from opening cases that are more than three years old. Still, tax lawyers  
15 estimate the agency could reap hundreds of millions of dollars from civil penalties,  
16 unpaid taxes and interest payments if widespread wrongdoing is found.

17 The agency appears to be taking aim both at companies that took improper  
18 tax deductions, and at executives who received favorable tax treatment and might  
19 have misreported income.

20 So far, rank-and-file employees who simply received potentially backdated  
21 stock options are not in the agency's cross hairs.

22 "If you were involved in the mischief, you would want to be worried," Mr.  
23 Ungar said. "If you weren't involved in it, then you are not in the same situation."

24 The tax scrutiny is the latest twist in what is perhaps the biggest financial  
25 scandal of the year and comes as the agency cracks down on misreported executive  
26 pay. The I.R.S. follows several other federal agencies that have begun investigations  
27 into the myriad problems that arise from improperly reported or backdated stock  
28 option grants.

The Securities and Exchange Commission has said it is examining 80  
companies for potential accounting and disclosure problems. On Wednesday, it  
underlined that focus with new rules on reporting executive compensation. The  
Justice Department has issued subpoenas to at least 35 companies and last week  
brought its first criminal charges, against two former executives of Brocade  
Communications. Now, tax troubles may be next.

By itself, backdating stock option grants is not necessarily illegal. But it can  
have severe tax consequences separate from potential accounting violations. While  
ordinary stock options generally qualify for favorable tax treatment, options issued at  
a discount to the market price do not. Backdating effectively allows such in-the-  
money options to appear in regulatory filings as if they were ordinary grants.

1 The I.R.S. is broadly focused on two main areas that may have been abused:  
2 performance-based stock options for top executives and incentive stock options that  
3 were frequently handed out to the rank and file. Each receives a different type of tax  
4 treatment.

5 Performance-based stock options are generally granted to the five highest-  
6 paid executives and can often be worth tens, if not hundreds of millions of dollars  
7 when they are cashed out. So long as the options meet certain standards, such as  
8 being granted at the market price, companies are allowed to take a tax deduction on  
9 that full amount.

10 But backdating — effectively granting stock options with a discount —  
11 automatically disqualifies those options from receiving the tax break. Instead, a  
12 company's tax deduction would be capped at \$1 million for each of the top five  
13 executives.

14 "If these companies have been deducting huge option grants that they actually  
15 couldn't deduct, that seems like a big pile of money out there," said Larry R.  
16 Langdon, a tax lawyer in Palo Alto, Calif., and a former I.R.S. commissioner.

17 Improperly awarded incentive stock options could lead to even more tax  
18 trouble. Backdating, which grants a discounted option, effectively voids the  
19 favorable tax treatment that incentive stock options provide employees, rendering  
20 their individual tax returns inaccurate. Companies, meanwhile, could be faulted for  
21 underreporting their payroll tax.

22 "Maybe it is not a widespread problem, but if this happened to five  
23 employees, you have five nightmares," said Fred Whittlesey, an executive pay  
24 consultant and head of the Compensation Venture Group. "Employees will have a  
25 legal and companies will have an ethical responsibility to insulate them from what  
26 happened based on actions of a few people."

27 The I.R.S. assembled a five-member task force to oversee its examinations  
28 about two months ago. And in the last few weeks, the Internal Revenue  
commissioner, Mark W. Everson, directed the agency's corporate auditors to look  
into potential tax issues as dozens of companies have come forward. In a statement,  
he called on them to "consult closely with the S.E.C. to determine which companies  
merit scrutiny."

Last week, I.R.S. officials held their first meeting with Linda Chatman  
Thomsen, the director of the S.E.C.'s enforcement division. She indicated that there  
were tax issues in the cases that securities regulators were investigating, Mr. Ungar  
said.

For now, I.R.S. officials are reviewing the files of 30 to 40 of the companies  
that have publicly disclosed problems, including some already facing scrutiny on  
other tax issues. Mr. Ungar said it could take months to more than a year before these  
initial cases are resolved. Much of the information will need to be supplied by the

companies themselves, not taken from tax returns. I.R.S. officials have not yet been in touch with the Justice Department about potential tax fraud.

### THE INDIVIDUAL DEFENDANTS' CERTIFICATION OF IMPROPER FINANCIALS

124. Blue Coat's 1999 through 2006 Forms 10-Q and Forms 10-K were reviewed, prepared and/or endorsed by the Individual Defendants. Specifically, the following chart details the defendants and other individuals who signed filings before the enactment of SOX:

Date	Filing	Person(s) Who Signed and Certified
12/30/1999	10Q	Michael J. Johnson (Chief Financial Officer); Bret Lawson (Controller and Chief Accounting Officer)
3/16/2000	10Q	Michael J. Johnson (Chief Financial Officer); Bret Lawson (Controller and Chief Accounting Officer)
7/28/2000	10K	Brian M. NeSmith (President, Chief Executive Officer and Director); Michael J. Johnson (Vice President, Chief Financial Officer and Secretary); Marc Andreessen (Director); David W. Hanna (Director); Michael A. Malcolm (Chairman of the Board); Stuart G. Phillips (Director); Andrew S. Rachleff (Director)
9/8/2000	10Q	Michael J. Johnson (Chief Financial and Accounting Officer)
12/15/2000	10Q	Michael J. Johnson (Chief Financial and Accounting Officer)
3/14/2001	10Q	Michael J. Johnson (Chief Financial and Accounting Officer)
7/16/2001	10K405	Brian M. NeSmith (President, Chief Executive Officer and Director); Robert Verheecke (Senior Vice President, Chief Financial Officer and Secretary); Marc Andreessen (Director); David W. Hanna (Chairman of the Board); Philip J. Koen (Director); Andrew S. Rachleff (Director)
9/13/2001	10Q	Robert Verheecke (Chief Financial and Accounting Officer)
12/14/2001	10Q	Robert Verheecke (Chief Financial and Accounting Officer)
3/14/2002	10Q	Robert Verheecke (Chief Financial and Accounting Officer)
7/29/2002	10K	Brian M. NeSmith (President, Chief Executive Officer and Director); Robert Verheecke (Senior Vice President, Chief Financial Officer and Secretary); Marc Andreessen (Director); David W. Hanna (Chairman of the Board); Philip J. Koen (Director); Andrew S. Rachleff (Director)

125. The following chart details the defendants and other individuals who made certifications of Blue Coat filings under SOX after its enactment:

Date	Filing	Person(s) Who Signed and Certified
9/11/2002	10-Q	Robert Verheecke (Chief Financial Officer and Accounting Officer) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Robert Verheecke (CFO)
12/16/2002	10-Q	Robert Verheecke (Chief Financial Officer and Accounting Officer) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Robert Verheecke (CFO)
3/14/2003	10-Q	Robert Verheecke (Chief Financial Officer and Accounting Officer) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Robert Verheecke (CFO)

7/29/2003	10-K	Brian M. NeSmith (President, Chief Executive Officer, and Director); Robert Verheecke (Senior Vice President, Chief Financial Officer, and Secretary); Marc Andreessen (Director); David W. Hanna (Chairman of the Board); Phillip J. Koen (Director); Andrew S. Rachleff (Director) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Robert Verheecke (CFO)
9/12/2003	10-Q	Robert Verheecke (Chief Financial Officer and Accounting Officer) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Robert Verheecke (CFO)
12/12/2003	10-Q	Robert Verheecke (Chief Financial Officer and Accounting Officer) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Robert Verheecke (CFO)
3/12/2004	10-Q	Robert Verheecke (Chief Financial Officer and Accounting Officer) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Robert Verheecke (CFO)
7/14/2004	10-K	Brian M. NeSmith (President, Chief Executive Officer, and Director); Robert Verheecke (Senior Vice President, Chief Financial Officer, and Secretary); Marc Andreessen (Director); Jay Shiveley (Director); David W. Hanna (Director); Andrew S. Rachleff (Director) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Robert Verheecke (CFO)
9/9/2004	10-Q	Robert Verheecke (Chief Financial Officer and Accounting Officer) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Robert Verheecke (CFO)
12/9/2004	10-Q	Robert Verheecke (Chief Financial Officer and Accounting Officer) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Robert Verheecke (CFO)
3/11/2005	10-Q	Robert Verheecke (Chief Financial Officer and Accounting Officer) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Robert Verheecke (CFO)
7/14/2005	10-K	Brian M. NeSmith (President, Chief Executive Officer, and Director); Kevin S. Royal (Senior Vice President and Chief Financial Officer); Marc Andreessen (Director); Jay Shiveley (Director); David W. Hanna (Director); Andrew S. Rachleff (Director) James A. Barth (Director) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Kevin S. Royal (CFO)
9/9/2005	10-Q	Kevin S. Royal (Senior Vice President and Chief Financial Officer) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Kevin S. Royal (CFO)
12/8/2005	10-Q	Kevin S. Royal (Senior Vice President and Chief Financial Officer) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Kevin S. Royal (CFO)
3/13/2006	10-Q	Kevin S. Royal (Senior Vice President and Chief Financial Officer) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Kevin S. Royal (CFO)
3/28/2007	10-Q	Kevin S. Royal (Senior Vice President and Chief Financial Officer) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Kevin S. Royal (CFO)
3/28/2007	10-K	Brian M. NeSmith (President, Chief Executive Officer, and Director); Kevin S. Royal (Senior Vice President and Chief Financial Officer); David W. Hanna (Chairman of the Board); James A. Barth (Director); Keith B. Geeslin (Director); Timothy A. Howes (Director) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Kevin S. Royal (CFO)
7/13/2007	10-K	Brian M. NeSmith (President, Chief Executive Officer, and Director); Kevin S. Royal (Senior Vice President and Chief Financial Officer); David W. Hanna (Chairman of the Board); James A. Barth (Director); Keith B. Geeslin (Director); Timothy A. Howes (Director) <b>SOX CERTIFICATION:</b> Brian NeSmith (CEO); Kevin S. Royal (CFO)

126. The SOX certifications signed in conjunction with the filing of Blue Coat's Forms 10-K and 10-Q contained language that was substantially similar or identical to the following

1 certification attached to Blue Coat's fiscal 2003 Form 10-K that was signed by defendants NeSmith  
2 and Verheecke:

3 I, [Brian NeSmith/Robert Verheecke], certify that:

- 4 1. I have reviewed this Annual Report on Form 10-K of Blue Coat Systems,  
5 Inc.;
- 6 2. Based on my knowledge, this Annual Report does not contain any untrue  
7 statement of a material fact or omit to state a material fact necessary to make  
8 the statements made, in light of the circumstances under which such  
9 statements were made, not misleading with respect to the period covered by  
10 this annual report;
- 11 3. Based on my knowledge, the financial statements, and other financial  
12 information included in this annual report, fairly present in all material  
13 respects the financial condition, results of operations and cash flows of the  
14 registrant as of, and for, the periods presented in this annual report;
- 15 4. The registrant's other certifying officers and I are responsible for establishing  
16 and maintaining disclosure controls and procedures (as defined in Exchange  
17 Act Rules 13a-14 and 15d-14) for the registrant and have:
  - 18 a) designed such disclosure controls and procedures to ensure that  
19 material information relating to the registrant, including its  
20 consolidated subsidiaries, is made known to us by others within those  
21 entities, particularly during the period in which this annual report is  
22 being prepared;
  - 23 b) evaluated the effectiveness of the registrant's disclosure controls and  
24 procedures as of a date within 90 days prior to the filing date of this  
25 annual report (the "Evaluation Date"); and
  - 26 c) presented in this annual report our conclusions about the  
27 effectiveness of the disclosure controls and procedures based on our  
28 evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our  
most recent evaluation, to the registrant's auditors and the audit committee of  
registrant's board of directors (or persons performing the equivalent  
functions):
  - a) all significant deficiencies in the design or operation of internal  
controls which could adversely affect the registrant's ability to record,  
process, summarize and report financial data and have identified for  
the registrant's auditors any material weaknesses in internal controls;  
and



b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

### ILLEGAL INSIDER SELLING

127. While in possession of the undisclosed material adverse information, the Insider Selling Defendants sold the following shares of Blue Coat stock that they had obtained, often by cashing in manipulated stock options:

Defendant	Start Date	End Date	Shares	Proceeds
ANDREESSEN	11/28/2000	8/26/2005	282,044	\$12,193,497.09
DE SIMONE	2/25/2004	9/6/2005	55,000	\$2,136,745.34
HANNA	3/30/2004	3/31/2004	64,135	\$3,356,221.65
JOHNSON	8/21/2000	12/14/2000	137,694	\$10,921,802.47
LAUGHLIN	8/19/2005	12/9/2005	11,987	\$481,608.17
MALCOLM	6/7/2000	9/29/2000	500,000	\$42,109,690.00
NESMITH	6/16/2000	2/27/2004	412,877	\$23,437,748.01
PHILLIPS	6/9/2000	12/13/2000	3,160,490	\$252,836,524.46
ROBIN	8/21/2000	12/12/2000	125,000	\$10,711,831.35
SCHARBER	5/21/2001	6/27/2001	60,000	\$351,730.00
VERHEECKE	12/15/2003	3/31/2004	22,000	\$1,020,080.50
<b>Total:</b>			<b>4,873,427</b>	<b>\$361,104,941.62</b>

### DAMAGES TO BLUE COAT

128. As a result of the defendants' improprieties, the Company has and will need to expend significant sums of money, including the following:

(a) Costs incurred from directing resources to investigate the illegal backdating and to restate Blue Coat's prior financial results. Blue Coat's expenses in connection with the investigation and the restatement totaled approximately \$10.5 million as of January 31, 2007;

(b) Costs incurred from increased Directors' & Officers' Insurance premiums as a result of the illegally manipulated stock option grants;

(c) Enormous tax liabilities from improper deductions taken on backdated option grants;

1 (d) Costs of potential liability to employees whose stock options will be cancelled  
2 due to stock options manipulation issues;

3 (e) Costs incurred with paying taxes on behalf of rank and file employees and  
4 former employees who inadvertently exercised manipulated option grants;

5 (f) Costs incurred from the Company's reduced ability to borrow funds or raise  
6 capital as a result of potential ratings downgrades;

7 (g) Costs incurred from severance paid to employees who have resigned or have  
8 been terminated and costs incurred to hire persons to replace those employees; and

9 (h) Costs incurred from having to allocate sufficient resources to correct Blue  
10 Coat's defective internal controls.

11 **DERIVATIVE AND DEMAND FUTILITY ALLEGATIONS**

12 129. Plaintiffs bring this action derivatively in the right and for the benefit of Blue Coat to  
13 redress injuries suffered, and to be suffered, by the Company as a direct result of the violations of the  
14 California Corporations Code, federal securities laws, breaches of fiduciary duty, abuse of control,  
15 gross mismanagement, waste of corporate assets and unjust enrichment, as well as the aiding and  
16 abetting thereof, by the Individual Defendants. Blue Coat is named as a nominal defendant solely in  
17 a derivative capacity. This is not a collusive action to confer jurisdiction on this Court that it would  
18 not otherwise have.

19 130. Plaintiffs will adequately and fairly represent the interests of Blue Coat in enforcing  
20 and prosecuting its rights.

21 131. Plaintiffs are and were owners of the stock of Blue Coat during times relevant to the  
22 Individual Defendants' wrongful course of conduct alleged herein, and remain shareholders of the  
23 Company.

24 132. The following six individuals comprised the Board of Blue Coat at the time of the  
25 filing of original complaint: defendants Barth, Geeslin, Hanna, Howes and NeSmith and Jay W.  
26 Shiveley III ("Shiveley"). Shively passed away on October 19, 2006. Plaintiffs did not make any  
27 demand on the Board of Blue Coat to institute this action because such a demand would have been a  
28 futile, wasteful and useless act.

133. Defendants Hanna and NeSmith are liable to Blue Coat for the undeserved compensation that they received as a result of the stock options that they manipulated. Specifically, these defendants approved and received manipulated option grants on April 4, 2001 and July 10, 2002. These defendants are interested because they engaged in prohibited self-dealing in that they authorized the granting of manipulated options to themselves and later sold shares, thus obtaining illegal proceeds at the Company's expense. Accordingly, demand is futile as to defendants Hanna and NeSmith because: (i) they face a sufficiently substantial likelihood of liability in connection with their illegally manipulated Company stock options; and (ii) they have a financial interest in the options that they illegally manipulated and the proceeds they gained from the exercise of those options.

134. As alleged above, the Board and its committees played critical roles in the administration of the Plans and the granting of Blue Coat stock options. The following chart details the defendants and other individuals who were members of the Board at the time the first complaint in this consolidated action was filed, who approved or acquiesced in the approval of manipulated options as directors and members of the Audit Committee:

Manipulated Options Grant Date	Audit Committee Members	Compensation Committee Members	Stock Option Committee	Directors
April 17, 2000	-	Hanna	-	Hanna, NeSmith
April 4, 2001	-	Hanna	-	Hanna, NeSmith
May 1, 2001	-	Hanna	-	Hanna, NeSmith
July 10, 2002	Hanna	Hanna	-	Hanna, NeSmith
July 30, 2003	Hanna	Hanna	-	Hanna, NeSmith
February 4, 2004	Hanna	Hanna	-	Hanna, NeSmith
May 28, 2004	Hanna	Hanna	-	Hanna, NeSmith, Shiveley
August 26, 2004	Hanna	Hanna	-	Hanna, NeSmith, Shiveley
May 2, 2005	Barth, Hanna	Hanna	-	Barth, Hanna, NeSmith, Shiveley
August 16, 2005	Barth, Hanna	Hanna	NeSmith	Barth, Hanna, NeSmith, Shiveley

The Board and its committees should have properly informed themselves of the circumstances surrounding the options granted to Blue Coat insiders before approving them. Instead, the Board and

1 Audit Committee repeatedly and recklessly ignored the following circumstances surrounding Blue  
2 Coat's option grants:

- 3 • The April 17, 2000 grant was dated at the lowest share price for the  
4 period beginning November 19, 1999 through December 20, 2000;
- 5 • The April 4, 2001 grant was dated at the *lowest share price of Blue*  
6 *Coat's fiscal year* ending April 30, 2001;
- 7 • The May 1, 2001 grant was dated at the lowest share price of the  
8 month;
- 9 • The July 31, 2001 grant was dated at the lowest share price of the  
10 month;
- 11 • The July 10, 2002 grant was dated at the *lowest share price of Blue*  
12 *Coat's fiscal year* ending April 30, 2003;
- 13 • The July 30, 2003 grant was dated within \$0.08 of the lowest share  
14 price of the fiscal year ended April 30, 2004 and was disclosed  
15 approximately 3 weeks late;
- 16 • The September 3, 2003 grant was dated within \$0.04 of the lowest  
17 share price of the month and was disclosed over 6 weeks late;
- 18 • The May 28, 2004 grant was dated with \$1.28 or 4.8% of the lowest  
19 share price of the five month period of February 9, 2004 to July 9,  
20 2004 and was disclosed over 2 weeks late;
- 21 • The August 26, 2004 grant was dated within \$1.54 of the lowest share  
22 price for the fiscal year ended April 30, 2005 and was disclosed over  
23 *9 months late*;
- 24 • The February 4, 2004 grant was dated just before the disclosure of  
25 positive non-public material information that precipitated a 101%  
26 appreciation in Blue Coat's stock price.
- The May 2, 2005 grant was dated just before the disclosure of  
positive non-public material information that precipitated a 39%  
appreciation in Blue Coat's stock price.
- The August 16, 2005 grant was dated just before the disclosure of  
positive non-public material information that precipitated a 36%  
appreciation in Blue Coat's stock price.

27 The fact that these options were routinely approved by the committees of the Board when they were  
28 dated at or near the Company's lowest closing prices for the respective month in which the options

1 were granted – or just before the release of positive undisclosed material information – establishes  
2 that these decisions were not informed. As a result of the Board and its committee's breaches of  
3 fiduciary duties, Blue Coat was recently forced to admit that "*nearly all* of [its] stock options granted  
4 since November 18, 1999 were subject to revised measurement dates." Accordingly, there is  
5 reasonable doubt that defendants Barth, Geeslin, Hanna and NeSmith are disinterested because they  
6 face sufficiently substantial liability for their breaches of fiduciary duty to Blue Coat. The Board  
7 and its committees' decisions to approve these problematic options were not products of valid  
8 business judgment. Thus, demand would have been futile as to defendants Barth, Geeslin, Hanna  
9 and NeSmith.

10 135. As alleged above, the Compensation Committee was specifically responsible for  
11 administering the Plans. Defendant Hanna, as a member of the Compensation Committee, approved  
12 backdated stock option grants. Specifically, Hanna approved manipulated stock options grants dated  
13 April 17, 2000, April 4, 2001, May 1, 2001, July 31, 2001, July 10, 2002, July 30, 2003, September  
14 3, 2003, February 4, 2004, May 28, 2004, August 26, 2004, May 2, 2005 and August 16, 2005. Blue  
15 Coat has admitted that "nearly all" options granted since its initial public offering are subject to  
16 revised measurement dates. The Compensation Committee's inept practices directly contributed to  
17 this shocking admission. These practices included the use of faxed consent forms without any  
18 follow-up procedures. Hanna breached his fiduciary duties owed to Blue Coat because he did not act  
19 to inform himself of the circumstances surrounding Blue Coat's option grants or to take reasonable  
20 steps to make sure that his faxed consents were properly followed, thereby causing or allowing the  
21 Company's executives to obtain unreasonable and unreported compensation via the manipulation of  
22 stock option grants. Accordingly, there is reasonable doubt that Hanna is disinterested because he  
23 faces a sufficiently substantial threat of liability for his breaches of fiduciary duty to Blue Coat. The  
24 Compensation Committee's decisions to approve the option grants were not the product of valid  
25 business judgment. Thus, demand would have been futile as to defendant Hanna.

26 136. Defendants Barth and Hanna were members of the Audit Committee during the  
27 approval of the manipulated options grants alleged above. Blue Coat has admitted that "nearly all"  
28 of its stock options granted since its initial public offering are subject to revised grant dates.

1 According to the Audit Committee's charter effective during 2000, the Audit Committee was  
2 responsible for reviewing Blue Coat's significant accounting and reporting principles, policies and  
3 practices. These principles, policies and practices included Blue Coat's adherence to SFAS No. 123,  
4 "Accounting for Stock-Based Compensation" and Accounting Principles Board Opinion No. 25  
5 ("APB 25"). Under SFAS No. 123 and APB 25, a compensation expense must be taken if options  
6 are not granted at fair market value. Because defendants' illegally-backdated options resulted in  
7 below fair market value grants, Blue Coat was forced to restate its prior financials to record stock  
8 option compensation expenses. Blue Coat incurred over \$10.5 million in expenses preparing that  
9 restatement. Accordingly, there is reasonable doubt that defendants Barth and Hanna are  
10 disinterested because they face a sufficiently substantial threat of liability for their breaches of  
11 fiduciary duty to Blue Coat. Thus, demand would have been futile as to defendants Barth and  
12 Hanna.

13 137. The Audit Committee is also responsible, under its charter, for evaluating and  
14 replacing the independent auditor. The Audit Committee allowed E&Y to remain as Blue Coat's  
15 auditor since its initial public offering. During that time, "nearly all" of Blue Coat's option  
16 measurement dates were manipulated. As a result, Blue Coat incurred over \$10.5 million in  
17 expenses to downward restate its earnings by over \$49 million dollars. The findings of the  
18 restatement and the facts concerning E&Y's involvement were readily available to the Audit  
19 Committee as of March 2007. Nevertheless, as of the last shareholder meeting held April 20, 2007,  
20 the Audit Committee recommended that E&Y remain as Blue Coat's independent registered public  
21 accountants. Demand is futile as to defendants Barth and Hanna because the Audit Committee's  
22 decision to continue to retain E&Y was not the product of valid business judgment.

23 138. Each of the Individual Defendants knew adverse, non-public information regarding  
24 the improper accounting as a result of their access to and review of internal corporate documents,  
25 attendance at Board meetings, and conversations and connections with other corporate officers,  
26 employees and directors. In addition, the following current members of the Blue Coat Board  
27 participated in the illegal insider selling (some of which include the selling of stock acquired through  
28 the exercising of illegally backdated stock options): (a) defendant Hanna sold 64,135 of his

1 personally-held shares for \$3,356,221.65 in proceeds while in possession of material, non-public  
 2 information concerning the illegally undisclosed backdating stock-option grant practices; and (b)  
 3 defendant NeSmith sold 412,877 of his personally-held shares for \$23,437,748.01 in proceeds while  
 4 in possession of material, non-public information concerning the illegally undisclosed backdating  
 5 stock-option grant practices. Because these defendants received a personal financial benefit from the  
 6 challenged insider trading transactions, these defendants are interested. They also face a sufficiently  
 7 substantial likelihood of liability for breach of their fiduciary duties for insider selling. Because  
 8 these defendants breached their fiduciary duties and are interested, any demand upon them would  
 9 have been futile.

10 139. Defendant NeSmith also faces liability as the sole member of the Stock Option  
 11 Committee during 2005 and 2006. On March 28, 2007, Blue Coat disclosed that "*nearly all* of [Blue  
 12 Coat's] stock options granted since November 18, 1999 were subject to revised measurement dates."  
 13 This admission includes options granted to non executive employees during 2005 through 2006.  
 14 Defendant NeSmith as the sole member of the Stock Option Committee during those years was  
 15 responsible for administering those grants. Accordingly, demand would have been futile as to  
 16 defendant NeSmith because he faces a sufficiently substantial threat of liability.

17 140. The principal professional occupation of NeSmith is his employment with Blue Coat,  
 18 pursuant to which he received and continues to receive substantial monetary compensation and other  
 19 benefits. Specifically, Blue Coat paid NeSmith the following compensation:

Fiscal			Securities
Year	Salary	Bonus	Underlying Options
2006	\$250,000	\$6,963	27,000
2005	\$250,000	-	-
2004	\$135,000	-	50,000
2003	\$20,000	-	100,000
2002	\$250,000	-	-
2001	\$225,000	-	-
2000	\$175,000	-	200,000
1999	\$28,494	-	2,000,000

26 Accordingly, NeSmith lacks independence from defendants Barth and Hanna, who are not  
 27 disinterested and/or independent and who exert influence over NeSmith's compensation by virtue of  
 28 their positions as members of the Compensation Committee. The Compensation Committee has the

1 authority to review and approve NeSmith's base salary, bonus and equity compensation. This lack of  
2 independence rendered defendant NeSmith incapable of impartially considering a demand to  
3 commence and vigorously prosecute this action.

4 141. Each of the key officers and directors knew of and/or directly benefited from the  
5 wrongdoing complained of herein.

6 142. The Director Defendants of Blue Coat, as more fully detailed herein, participated in,  
7 approved and/or permitted the wrongs alleged herein to have occurred and participated in efforts to  
8 conceal or disguise those wrongs from Blue Coat's stockholders or recklessly and/or negligently  
9 disregarded the wrongs complained of herein, and are therefore not disinterested parties.

10 143. In order to bring this suit, all of the directors of Blue Coat would have been forced to  
11 sue themselves and persons with whom they have extensive business and personal entanglements,  
12 which they would not have done, thereby excusing demand.

13 144. The acts complained of constitute violations of the fiduciary duties owed by Blue  
14 Coat's officers and directors and these acts are incapable of ratification.

15 145. Blue Coat has been and will continue to be exposed to significant losses due to the  
16 wrongdoing complained of herein, yet the Individual Defendants and Board have not filed any  
17 lawsuits against themselves or others who were responsible for the wrongful conduct in an attempt to  
18 recover for Blue Coat any part of the damages the Company suffered and will suffer thereby.

19 146. If Blue Coat's current and past officers and directors are protected against personal  
20 liability for their acts of mismanagement, abuse of control and breach of fiduciary duty alleged in  
21 this Complaint by directors' and officers' liability insurance, they caused the Company to purchase  
22 such insurance for their protection with corporate funds, *i.e.*, monies belonging to Blue Coat's  
23 stockholders. However, due to certain changes in the language of directors' and officers' liability  
24 insurance policies in the past few years, the policies covering the defendants in this case contain  
25 provisions that eliminate coverage for any action brought directly by Blue Coat against these  
26 defendants, known as, *inter alia*, the "insured versus insured exclusion." As a result, if these  
27 directors were to sue themselves or certain Blue Coat officers, there would be no directors' and  
28 officers' insurance protection. If there is no directors' and officers' liability insurance, then the



1 current directors will not cause Blue Coat to sue defendants, since they will face a large uninsured  
2 liability. This is a further reason why they would not have brought such a suit. On the other hand, if  
3 the suit is brought derivatively, as this action is brought, such insurance coverage exists and will  
4 provide a basis for the Company to effectuate recovery.

5 147. Moreover, despite the Individual Defendants having knowledge of the claims and  
6 causes of action raised by plaintiffs, the Board has failed and refused to seek to recover for Blue  
7 Coat for any of the wrongdoing alleged by plaintiffs herein.

8 148. Plaintiffs have not made any demand on shareholders of Blue Coat to institute this  
9 action since such demand would be a futile and useless act for the following reasons:

10 (a) Blue Coat is a publicly-held company with over 14.4 million shares  
11 outstanding, and thousands of shareholders;

12 (b) Making demand on such a number of shareholders would be impossible for  
13 plaintiffs who have no way of finding out the names, addresses or phone numbers of shareholders;  
14 and

15 (c) Making demand on all shareholders would force plaintiffs to incur huge  
16 expenses, assuming all shareholders could be individually identified.

17 **DEFENDANTS ACTIVELY CONCEALED THEIR ILLEGAL BACKDATING**  
18 **PRACTICES**

19 149. At times relevant hereto, defendants took affirmative steps to conceal their backdating  
20 actions by authorizing or otherwise causing the Company to issue proxy statements, Form 3s, Form  
21 4s, Form 5s, Form 10-Qs, Form 10-Ks and other SEC filings and public statements that contained  
22 false disclosures concerning the grant dates of options granted to Blue Coat insiders. These false  
23 disclosures prevented plaintiffs from recognizing that Blue Coat insiders were illegally backdating  
24 their stock option grants.

25 150. Indeed, prior to the March 18, 2006 *Wall Street Journal* article, titled "The Perfect  
26 Payday: Some CEOs reap millions by landing stock options when they are most valuable. Luck – or  
27 something else?", the public consensus was that favorable option timing could be largely explained  
28 by an insider's ability to predict that favorable company news was coming and that insiders were

1 timing grants to take advantage of it. This consensus was not challenged until academic research,  
2 which included examinations of thousands of companies, revealed that it was likely that grant dates  
3 had been filled in retroactively.

4 151. Thus, due to the public consensus that favorable option timing could be explained  
5 away by an insiders' ability to predict the stock price and defendants' active concealment of their  
6 backdating practices, shareholders were prevented from recognizing the validity of the claims prior  
7 to the March 18, 2006 *Wall Street Journal* article. Even after that article was published, there were  
8 insufficient warnings that implicated Blue Coat in the backdating scandal. The first public disclosure  
9 of options manipulation specifically at Blue Coat did not occur until July 14, 2006.

10 152. Further, plaintiffs' ignorance of defendants' illegal backdating practices was not  
11 attributable to a lack of due diligence. It would be unreasonable to expect plaintiffs—typical  
12 shareholders—to undertake costly and extensive academic research and statistical analysis when  
13 defendants' false public statements indicated that stock options were being properly granted. In any  
14 case, plaintiffs are entitled to rely upon the truthfulness of the disclosures contained within Blue  
15 Coat's public statements and SEC filings.

16 153. Following the July 14, 2006 public disclosure of backdating practices at Blue Coat,  
17 plaintiffs conducted an investigation of defendants' prior option grants, discovered numerous  
18 suspicious grants dated at extremely favorable exercise prices and expeditiously brought this action  
19 on behalf of Blue Coat to preserve the Company's claims against the wrongdoers responsible for  
20 illegal backdating.

21 154. It is apparent that defendants' scheme to profit from the backdated option grants was  
22 continuous, dating back to 1999. Indeed, this scheme was a continuing and involved process that  
23 included: (i) the manipulation of option grant dates; (ii) the approval of manipulated grants; (iii) the  
24 holding of the manipulated grants throughout their respective vesting periods; (iv) the concealment  
25 of the backdated grants via improper disclosures in Blue Coat's SEC filings and other public  
26 statements; (v) the improper accounting for the backdated options over the vesting periods; and (vi)  
27 finally, the exercising of the backdated options for profit. This continuous scheme, although it  
28

1 stretches back over 8 years, has resulted in present-day damages to Blue Coat that have only recently  
2 accrued as alleged above.

3 **COUNT I**

4 **Against Defendants NeSmith and Verheecke for Disgorgement**  
5 **under the Sarbanes-Oxley Act of 2002**

6 155. Plaintiffs incorporate by reference and reallege each and every allegation set forth  
7 above, as though fully set forth herein.

8 156. Section 304 of the Sarbanes-Oxley Act of 2002 provides that if a public company  
9 prepares an accounting restatement due to material non-compliance with any financial reporting  
10 requirement under federal securities laws, and such non-compliance resulted from misconduct, then  
11 the company's chief executive officer and chief financial officer must reimburse the company for  
12 certain payments made by the company to those executives. Section 304, entitled "Forfeiture of  
13 Certain Bonuses and Profits," provides in full:

14 (a) **Additional compensation prior to noncompliance with**  
15 **commission financial reporting requirements.** If an issuer is required to  
16 prepare an accounting restatement due to the material non-compliance of the  
17 issuer, as a result of misconduct, with any financial reporting requirement  
under the securities laws, *the chief executive officer and chief financial*  
*officer of the issuer shall reimburse the issuer for –*

18 1. any bonus or other incentive-based or equity-based  
19 compensation received by that person from the issuer during the 12-  
20 month period following the first public issuance or filing with the  
Commission (whichever first occurs) of the financial document  
embodying such financial reporting requirement; and

21 2. any profits realized from the sale of securities of the issuer  
22 during that 12-month period.

23 (b) **Commission exemption authority.** The Commission may exempt  
24 any person from the application of subsection (a), as it deems necessary and  
appropriate.

25 157. Blue Coat restated its financial statements filed from 2000 to 2006 due to the material  
26 non-compliance of such statements with federal securities laws reporting requirements. These  
27 restatements resulted from "misconduct" within the meaning of Section 304 of the Sarbanes-Oxley  
28 Act of 2002. As a result, defendant NeSmith, as Blue Coat's CEO and defendant Verheecke as Blue

1 Coat's CFO are required to reimburse Blue Coat for all bonuses or other incentive-based or  
2 equity-based compensation received by them from the Company during the period July 30, 2002 (the  
3 date of enactment of the Sarbanes-Oxley Act of 2002) through the present. Further, defendants  
4 NeSmith and Verheecke also are liable to Blue Coat for any profits realized from the sales of  
5 securities by the Company during that same period of time.

6 158. Defendants NeSmith and Verheecke are also liable to plaintiffs for reasonable costs  
7 and attorneys' fees in the prosecution of this derivative action on behalf of Blue Coat.

8 **COUNT II**

9 **Against Defendants NeSmith, Andreessen, Hanna, Malcolm, Phillips and Rachleff for**  
10 **Violation of Section 14(a) of the Exchange Act**

11 159. Plaintiffs incorporate by reference and realleges each and every allegation set forth  
12 above, as though fully set forth herein.

13 160. The Individual Defendants issued, caused to be issued and participated in the  
14 issuance of materially false and misleading written statements to shareholders which were contained  
15 in the Company's proxy statements issued on August 26, 2003, August 26, 2004 and August 17,  
16 2005 (collectively referred to as the Proxies). The Proxies contained proposals to Blue Coat's  
17 shareholders that they vote to elect the Director Defendants as Blue Coat directors. The Proxies,  
18 however, misrepresented and failed to disclose that the Company's executives were engaged in the  
19 improper backdating or manipulation of stock options and that the Director Defendants were  
20 approving those options as dated. As a result of the actions and inactions of Blue Coat's  
21 management and directors, the Company has been forced to admit that "nearly all" of its stock  
22 options issued since its initial public offering were subject to revised measurement dates. This  
23 undisclosed information was material to Blue Coat's shareholders decisions as to whether or not they  
24 should elect the Director Defendants because it directly impacted upon the integrity of Blue Coat's  
25 management and its Board.

26 161. By reasons of the conduct alleged herein, defendants NeSmith, Andreessen,  
27 Hanna, Malcolm, Phillips and Rachleff, who were directors that caused or allowed the issuance of  
28 this proxy statement, violated §14(a) of the Exchange Act. As a direct and proximate result of the

1 Director Defendants' wrongful conduct, Blue Coat misled and/or deceived its shareholders by falsely  
2 portraying the integrity of the directors proposed for election.

3 162. Plaintiffs, on behalf of Blue Coat, thereby seek relief for damages inflicted upon  
4 the Company in connection with the improper election of Blue Coat's directors based upon the  
5 misleading and incomplete proxy materials.

6 **COUNT III**

7 **Against the Options Recipient Defendants for Unjust Enrichment**

8 163. Plaintiffs incorporate by reference and reallege each and every allegation contained  
9 above, as though fully set forth herein.

10 164. By their wrongful acts and omissions, defendants were unjustly enriched at the  
11 expense of and to the detriment of Blue Coat. These wrongful acts included the approval of  
12 improperly manipulated stock options by the Director Defendants and defendant Laughlin as well as  
13 the receipt of undeserved compensation in connection with those options by the Options Recipient  
14 Defendants.

15 165. Plaintiffs, as shareholders and representatives of Blue Coat, seek restitution from  
16 these defendants, and each of them, and seek an order of this Court disgorging all profits, benefits  
17 and other compensation obtained by these defendants, and each of them, from their wrongful  
18 conduct and fiduciary breaches.

19 **COUNT IV**

20 **Against the Director Defendants and Defendants Laughlin and Thornton for Breach of**  
21 **Fiduciary Duty for Approving Improperly Manipulated Stock Option Grants to the**  
22 **Options Recipient Defendants**

23 166. Plaintiffs incorporate by reference and reallege each and every allegation contained  
24 above, as though fully set forth herein.

25 167. The Director Defendants and defendants Laughlin and Thornton owed and owe Blue  
26 Coat fiduciary obligations. By reason of their fiduciary relationships, these defendants owed and  
27 owe Blue Coat the highest obligation of good faith, fair dealing, loyalty and due care.  
28

168. The Director Defendants and defendant Laughlin, and each of them, violated and breached their fiduciary duties of care, loyalty, reasonable inquiry, oversight, good faith and supervision.

169. Each of the Director Defendants and defendants Laughlin and Thornton had actual or constructive knowledge that they had approved the improper manipulation of stock option grants and the corresponding issuance of inaccurate financial results that did not properly account for the stock option grants and failed to correct or prevent these improprieties. These actions could not have been a good faith exercise of prudent business judgment to protect and promote the Company's corporate interests.

170. As a direct and proximate result of the Director Defendants and defendant Laughlin's and Thornton's failure to perform their fiduciary obligations, Blue Coat has sustained significant damages. As a result of the misconduct alleged herein, these defendants are liable to the Company.

171. Plaintiffs on behalf of Blue Coat have no adequate remedy at law.

COUNT V

**Against the Insider Selling Defendants for Violation of  
California Corporations Code §25402**

172. Plaintiffs incorporate by reference and reallege each and every allegation set forth above, as though fully set forth herein.

173. At the time that the Insider Selling Defendants sold their Blue Coat common stock as set forth herein, by reason of their high executive and/or directorship positions with Blue Coat, the Insider Selling Defendants had access to highly material information regarding the Company, including the information set forth herein regarding the true adverse facts concerning defendants' backdating practices. Further, the Insider Selling Defendants cashed in their illegally backdated stock options and sold them for over \$48 million in proceeds.

174. At the time of such sales, that information was not generally available to the public or the securities markets. Had such information been generally available, it would have significantly reduced the market price of Blue Coat shares at that time.

1 175. The Insider Selling Defendants, and each of them, had actual knowledge of material,  
2 adverse, non-public information and thus sold their Blue Coat common stock in California in  
3 violation of California Corporations Code §25402.

4 176. Pursuant to California Corporations Code §25502.5, the Insider Selling Defendants,  
5 and each of them, are liable to Blue Coat for damages in an amount up to three times the difference  
6 between the price at which Blue Coat common stock was sold by the defendants, and each of them,  
7 and the market value which that Blue Coat common stock would have had at the time of the sale if  
8 the information known to the defendants, and each of them, had been publicly disseminated prior to  
9 that time and a reasonable time had elapsed for the market to absorb the information.

#### 10 **COUNT VI**

#### 11 **Against the Director Defendants and Defendant Laughlin for Violation of California** 12 **Corporations Code §25403**

13 177. Plaintiffs incorporate by reference and reallege each and every allegation set forth  
14 above, as though fully set forth herein.

15 178. The Director Defendants and defendants Laughlin and Thornton, through their  
16 positions, possessed control and influence over the Insider Selling Defendants' sale of Blue Coat  
17 common stock in violation of the California Corporations Code. The Director Defendants and  
18 defendants Laughlin and Thornton are statutorily liable to the same extent as the Insider Selling  
19 Defendants under California Corporations Code §25403.

20 179. The Director Defendants and defendants Laughlin and Thornton were aware of the  
21 Insider Selling Defendants' knowledge of the material adverse non-public information and they were  
22 aware of the Insider Selling Defendants' intent to sell Blue Coat common stock while in possession  
23 of material adverse non-public information.

24 180. The Director Defendants and defendants Laughlin and Thornton are culpable for the  
25 Insider Selling Defendants' underlying violations of California Corporations Code §25402 because  
26 of their knowledge and ability to control and influence the Insider Selling Defendants and because  
27 their involvement in preparing and/or approving financials that improperly accounted for the  
28

1 Company's compensation expenses related to grants of stock options to Blue Coat officers, directors  
2 and employees.

3 181. Under California Corporations Code §25403, the Director Defendants and defendants  
4 Laughlin and Thornton, and each of them, are liable to Blue Coat for damages in an amount up to  
5 three times the difference between the price at which Blue Coat common stock was sold by the  
6 Insider Selling Defendants, and each of them, and the market value which that Blue Coat common  
7 stock would have had at the time of the sale if the information known to the Individual Defendants,  
8 and each of them, had been publicly disseminated prior to that time and a reasonable time had  
9 elapsed for the market to absorb the information.

10 **COUNT VII**

11 **Against the Insider Selling Defendants for Breach of Fiduciary**  
12 **Duties for Insider Selling and Misappropriation of Information**

13 182. Plaintiffs incorporate by reference and reallege each and every allegation contained  
14 above, as though fully set forth herein.

15 183. At the time of the stock sales stated herein, the Insider Selling Defendants knew the  
16 information described above, and sold Blue Coat common stock on the basis of such information.

17 184. The information described above was proprietary non-public information concerning  
18 the Company's financial condition and future business prospects. It was a proprietary asset  
19 belonging to the Company, which the Insider Selling Defendants used for their own benefit when  
20 they sold Blue Coat common stock.

21 185. At the time of their stock sales, the Insider Selling Defendants knew that the  
22 Company's revenues were materially overstated because of the undisclosed stock option and other  
23 related compensation expenses. The Insider Selling Defendants' sales of Blue Coat common stock  
24 while in possession and control of this material adverse and non-public information was a breach of  
25 their fiduciary duties of loyalty and good faith.

26 186. Since the use of the Company's proprietary information for their own gain constitutes  
27 a breach of the Insider Selling Defendants' fiduciary duties, the Company is entitled to the  
28 imposition of a constructive trust on any profits the Insider Selling Defendants obtained thereby.



**COUNT VIII**

**Against All Defendants for Abuse of Control**

187. Plaintiffs incorporate by reference and reallege each and every allegation contained above, as though fully set forth herein.

188. The Individual Defendants' misconduct alleged herein constituted an abuse of their ability to control and influence Blue Coat, for which they are legally responsible.

189. As a direct and proximate result of the Individual Defendants' abuse of control, Blue Coat has sustained significant damages.

190. As a result of the misconduct alleged herein, the Individual Defendants are liable to the Company.

191. Plaintiffs on behalf of Blue Coat have no adequate remedy at law.

**COUNT IX**

**Against All Defendants for Breach of Fiduciary Duty of Gross Mismanagement**

192. Plaintiffs incorporate by reference and reallege each and every allegation contained above, as though fully set forth herein.

193. By their actions alleged herein, the Individual Defendants, either directly or through aiding and abetting, abandoned and abdicated their responsibilities and fiduciary duties with regard to prudently managing the assets and business of Blue Coat in a manner consistent with the operations of a publicly held corporation.

194. As a direct and proximate result of the Individual Defendants' gross mismanagement and breaches of duty alleged herein, Blue Coat has sustained significant damages.

195. As a result of the misconduct and breaches of duty alleged herein, the Individual Defendants are liable to the Company.

196. Plaintiffs on behalf of Blue Coat have no adequate remedy at law.

**COUNT X**

**Against All Defendants for Waste of Corporate Assets**

197. Plaintiffs incorporate by reference and reallege each and every allegation contained above, as though fully set forth herein.

1 198. As a result of the improprieties alleged herein, and by failing to properly consider the  
2 interests of the Company and its public shareholders by failing to conduct proper supervision,  
3 defendants have caused Blue Coat to waste valuable corporate assets and incur costs to conduct  
4 investigations, hire outside counsel, accounting firms and consultants, and to direct manpower to the  
5 task of potentially restating Blue Coat's past financials to correct for the improperly manipulated  
6 stock option grants.

7 199. As a result of the waste of corporate assets, the Individual Defendants are liable to the  
8 Company.

9 200. Plaintiffs on behalf of Blue Coat have no adequate remedy at law.

10 **COUNT XI**

11 **Against E&Y for Professional Negligence and Accounting Malpractice**

12 201. Plaintiffs incorporate by reference and reallege each and every allegation set forth  
13 above, as though fully set forth herein.

14 202. E&Y issued unqualified opinions on Blue Coat's financial statements issued between  
15 November 1999 and the present, stating that those financial statements were presented in accordance  
16 with GAAP based on E&Y's audits which were performed in accordance with Generally Accepted  
17 Auditing Standards ("GAAS"). GAAS, as approved and adopted by the American Institute of  
18 Certified Public Accountants ("AICPA"), govern the conduct of audit engagements. In fact, the  
19 audit reports were false and misleading due to, among other things, E&Y's failure to conduct the  
20 audits in accordance with GAAS and the fact that Blue Coat's financial statements issued between  
21 November 1999 and the present were not prepared in conformity with GAAP. E&Y's reports were  
22 in violation of GAAS, GAAP and SEC rules.

23 203. The objective of audits of financial statements by an independent auditor is for the  
24 auditor to express an opinion on the fairness with which such statements present, in all material  
25 respects, a company's financial position, results of operations and cash flows in conformity with  
26 GAAP. The auditor's report is the medium through which the auditor expresses its opinion or, if  
27 circumstances require, qualifies or disclaims an opinion. In either case, an auditor states that the  
28 audit has been conducted in accordance with GAAS. These standards require the auditor to state

1 whether, in its opinion, the financial statements are presented in accordance with GAAP and to  
2 identify those circumstances in which such principles have not been consistently observed in the  
3 preparation of the financial statements of the current period in relation to those of the preceding  
4 period.

5 204. E&Y was subject to general professional standards, including GAAS and GAAP, as  
6 alleged above. E&Y's audits of Blue Coat's financial statements issued between November 1999 and  
7 the present violated each of these standards.

8 205. E&Y is one of the largest international firms of certified public accountants and is a  
9 member of the AICPA. E&Y was the auditor of Blue Coat's financial statements between November  
10 1999 and the present. In addition, Blue Coat paid E&Y to review the Company's quarterly financial  
11 statements throughout this period. E&Y audited Blue Coat's financial statements issued between  
12 November 1999 and the present, and issued its audit opinions stating that those financial statements  
13 were fairly presented in accordance with GAAP, and that it had audited those financial statements in  
14 accordance with GAAS. Both of those statements were false. E&Y was aware of facts that  
15 undeniably precluded it from making those statements at the time they were made. Blue Coat's  
16 financial statements and E&Y's opinions on them were then used by Blue Coat with E&Y's consent  
17 to publicly disseminate Blue Coat's financial results in the filing of the Company's annual Forms 10-  
18 K with the SEC.

19 206. E&Y was negligent in failing to comply with GAAS as Blue Coat's independent  
20 accountant. E&Y issued unqualified opinions stating that the financial statements of Blue Coat were  
21 fairly presented in accordance with GAAP, when it was aware of or should have been aware of facts  
22 and circumstances that undermined such unqualified opinions and rendered them false and  
23 misleading.

24 207. In the course of performing its audit services, E&Y obtained evidential matter  
25 revealing the adverse facts detailed above about Blue Coat's undisclosed compensation, but  
26 improperly failed to require the Company to adjust its financial statements or make disclosures of  
27 such facts. As a result of its investigations and audit work, E&Y knew that the reports and financial  
28

1 statements described herein were materially misleading or negligently disregarded facts that showed  
2 that all such statements were materially misleading.

3       208. Because: (a) E&Y personnel spoke regularly with Blue Coat Board and Audit  
4 Committee members who were knowledgeable about the undisclosed option misdating; and (b) E&Y  
5 attended certain Board and Audit Committee meetings during which legal compliance was  
6 discussed, E&Y knew or negligently disregarded facts that indicated that it should have: (i)  
7 qualified its opinions on Blue Coat's financial statements issued between November 1999 and the  
8 present; or (ii) required the Company to adjust its financial statements; or (iii) refused to give  
9 opinions in light of the materially-adverse effects of the undisclosed facts about Blue Coat's financial  
10 condition, including the material overstatement of earnings based on the fact that Blue Coat's  
11 executive compensation expenses were being materially understated. The failure to make such  
12 qualification, correction, modification or withdrawal was a violation of GAAS, including the Fourth  
13 Standard of Reporting.

14       209. E&Y failed to require Blue Coat to disclose material adverse facts and allowed the  
15 Company to make material misrepresentations to its shareholders and to the investing public.

16       210. E&Y violated GAAS General Standard No. 3, which requires that due professional  
17 care must be exercised by the auditor in performance of the examination and the preparation of the  
18 audit report.

19       211. E&Y violated GAAS Standard of Field Work No. 2, which requires the auditor to  
20 make a proper study of existing internal controls, to determine whether reliance thereon was  
21 justified, and if such controls are not reliable, to expand the nature and scope of the auditing  
22 procedures to be applied. E&Y, knowing that Blue Coat's internal controls were insufficient, failed  
23 to expand its auditing procedures.

24       212. E&Y violated GAAS Standard of Field Work No. 3, which requires sufficient  
25 competent evidential matter be obtained through inspection, observation, inquiries and confirmations  
26 to afford a reasonable basis for an opinion to be issued on the subject financial statements. As  
27 described above, the accountants failed to obtain sufficient competent evidential matter as to Blue  
28 Coat's executive compensation reporting.

1           213. E&Y violated GAAS Standard of Reporting No. 1, which requires the audit report to  
2 state whether the financial statements are presented in accordance with GAAP. The opinions offered  
3 by E&Y falsely represented that Blue Coat's financial statements complied with GAAP, when E&Y  
4 knew or negligently disregarded that they did not for the reasons herein alleged.

5           214. E&Y violated GAAS Standard of Reporting No. 4 that requires, when an opinion on  
6 the financial statements as a whole cannot be expressed, that the reasons be stated. E&Y should  
7 have either stated that no opinion could be issued on Blue Coat's financial statements, or should have  
8 issued an adverse opinion stating that the financial statements were not fairly presented.

9           215. E&Y violated Standard of Field Work No. 1 and the standards set forth in AU §§310,  
10 320 and 327 by, among other things, failing to adequately plan its audit and properly supervise the  
11 work of its personnel so as to establish and carry out procedures reasonably designed to search for  
12 and detect the existence of errors and irregularities that would have a material effect upon Blue  
13 Coat's financial statements.

14           216. E&Y violated SAS No. 16 in that it failed to perform its examination with an attitude  
15 of professional skepticism and, in connection with the year-end 2003 audits, ignored numerous "red  
16 flags" that would reasonably have led to the discovery of the gross understatement of executive  
17 compensation expenses and overstatement of Blue Coat's earnings.

18           217. E&Y violated AU §316.20, which requires that additional procedures should be  
19 performed when evaluation at the financial-statement level indicates significant risk.

20           218. As a result of the foregoing, E&Y certification of Blue Coat's financial statements  
21 issued between November 1999 and the present falsely represented that the statements were audited  
22 pursuant to GAAS and that Blue Coat's financial statements were presented in conformity with  
23 GAAP. E&Y knew that such certification was false and misleading because, as detailed herein: (a)  
24 it knew or was negligent in not knowing that the Company's financial statements violated GAAP;  
25 and (b) E&Y knew that its audits had not complied with GAAS.

26           219. As a result of the services rendered to Blue Coat, E&Y's personnel were present at the  
27 Company's corporate headquarters and major operating offices. They examined or participated in  
28 reviews, investigations and audit procedures regarding the financial condition, business operations

1 and financial, accounting and management-control systems of Blue Coat. In the course of  
2 performing such services, E&Y's personnel had virtually unlimited access to substantial evidential  
3 matter revealing the adverse facts about the Company's non-compliance with the Plans and related  
4 reporting requirements, but improperly failed to consider such facts in the issuance of its opinions.

5 220. E&Y: (a) knew or were negligent in not knowing of the material, adverse, non-public  
6 information about the financial statements of Blue Coat, which was not disclosed; and (b)  
7 participated in drafting, reviewing and/or approving the misleading statements, releases, reports and  
8 other public representations of and about Blue Coat pleaded herein, involving the SEC reports on  
9 Form 10-K.

10 221. In performing auditing and accounting services on behalf of Blue Coat and engaging  
11 in the wrongful acts alleged herein, E&Y knew or should have known that the Company would, and  
12 did, transmit false and misleading financial information to the investing public. E&Y, however,  
13 failed to discharge its duties in adherence to GAAP and GAAS to detect such errors and  
14 irregularities.

15 222. In performing the auditing and accounting services to Blue Coat in the manner  
16 alleged herein, E&Y owed a duty to Blue Coat and its shareholders to use such skill, care and  
17 diligence as other members of its profession commonly exercised. E&Y, however, breached such  
18 duties by committing the wrongful acts and conduct alleged herein.

19 223. Blue Coat relied to its detriment on E&Y and was damaged thereby.

20 224. As a direct, foreseeable and proximate result of E&Y's breaches of duties owed to  
21 Blue Coat, the Company suffered damages.

## 22 **COUNT XII**

### 23 **Against Defendant E&Y for Aiding and Abetting Breaches of Fiduciary Duty, Abuse of** 24 **Control, Unjust Enrichment and Gross Mismanagement**

25 225. Plaintiffs incorporate by reference and reallege each and every allegation set forth  
26 above, as though fully set forth herein.

27 226. Defendant E&Y aided and abetted the Individual Defendants in breaching their  
28 fiduciary obligations owed to Blue Coat resulting in the wrongdoing and damages to those entities

1 complained of herein. E&Y knew or should have known that Blue Coat's financial statements for  
2 the period between November 1999 and the present contained were materially false and misleading.  
3 E&Y also knew, or should have known, that the false and misleading information would be used, in  
4 whole or in part, by Blue Coat to prepare its publicly-reported financial results and financial  
5 statements. Nevertheless, E&Y actively prepared the false and misleading information and thereby  
6 aided and abetted the Individual Defendants' breaches of fiduciary duty and their abuse of control,  
7 gross mismanagement and violation of their duty of candor to Blue Coat shareholders complained of  
8 herein.

9       227. As a direct, foreseeable and proximate result of E&Y aiding and abetting of  
10 defendants' breaches of fiduciary duty, Blue Coat has been damaged.

11                                   **PRAYER FOR RELIEF**

12       WHEREFORE, plaintiffs demand judgment as follows:

13       A. Against all of the defendants and in favor of Blue Coat for the amount of damages  
14 sustained by the Company as a result of the defendants' violations of the California Corporations  
15 Code, federal securities laws, breaches of fiduciary duties, abuse of control, gross mismanagement,  
16 waste of corporate assets, unjust enrichment, professional negligence and accounting malpractice;

17       B. Determining and awarding Blue Coat treble damages pursuant to California  
18 Corporations Code §25502.5(a) for the Insider Selling Defendants' violations of California  
19 Corporations Code §25402;

20       C. Against the Director Defendants and defendants Laughlin and Thornton and in favor  
21 of the Company, for the amount of damages the Company has sustained under California  
22 Corporations Code §25403;

23       D. Declaring that defendants NeSmith and Verheecke are liable under §302 of the SOX,  
24 and requiring them to reimburse Blue Coat for all bonuses or other incentive-based or equity-based  
25 compensation received by them at all relevant times;

26       E. Declaring and decreeing that the Director Defendants caused the Company to act in  
27 violation of §14(a) of the Exchange Act;

1 F. Directing Blue Coat to take all necessary actions to reform and improve its corporate  
2 governance and internal procedures to comply with applicable laws and to protect Blue Coat and its  
3 shareholders from a repeat of the damaging events described herein, including, but not limited to,  
4 putting forward for shareholder vote resolutions for amendments to the Company's By-Laws or  
5 Articles of Incorporation and taking such other action as may be necessary to place before  
6 shareholders for a vote the following Corporate Governance Policies:

7 1. a proposal to remove from the Board and its committees all directors who are  
8 found to have participated in the illegal stock options manipulations;

9 2. a proposal to strengthen the Board's supervision of operations and develop and  
10 implement procedures for greater shareholder input into the policies and guidelines of the Board;

11 3. a proposal to ensure that all stock options granted to executive and non-  
12 executive employees are properly awarded, valued and administered in accordance with the Plans  
13 and all applicable laws, regulations and rules;

14 4. a provision to control and limit insider stock selling;

15 5. a provision to permit the shareholders of Blue Coat to nominate at least three  
16 candidates for election to the Board; and

17 6. a proposal to appropriately test and then strengthen the internal audit and  
18 control functions.

19 G. Extraordinary equitable and/or injunctive relief as permitted by law, equity and state  
20 statutory provisions issued hereunder, including attaching, impounding or otherwise restricting the  
21 proceeds of defendants' trading activities, manipulated stock options or their other assets so as to  
22 assure that plaintiffs, on behalf of Blue Coat, have an effective remedy;

23 H. Directing an accounting of all undisclosed manipulated stock options granted,  
24 directing that all the unexercised backdated and/or improperly manipulated options granted to  
25 defendants be cancelled, ordering the financial gains obtained via the exercise of such stock options  
26 returned to the Company, and ordering Blue Coat to revise the Company's financial statements to  
27 reflect the truth concerning these option grants;  
28



I. Rescinding all contracts which provide for stock option grants between the Options Recipient Defendants and Blue Coat and that were entered into during times relevant hereto, with all sums, proceeds and profits under such contracts returned to the Company, and all such executory contracts cancelled and declared void;

J. Declaring that defendants' illicit and illegally obtained stock options, and all proceeds derived from the exercise thereof, and any assets or other property acquired in connection therewith, are and have been held in constructive trust by defendants for the Company's benefit from the true grant date of the manipulated stock options and other equity or incentive based compensation;

K. Awarding to Blue Coat restitution from the defendants, and each of them, and ordering disgorgement of all profits, benefits and other compensation obtained by the defendants through the improper manipulating of stock option grants;

L. Awarding to plaintiffs the costs and disbursements of this action, including reasonable attorneys' fees, accountants' and experts' fees, costs, and expenses; and

M. Granting such other and further relief as the Court deems just and proper.

**JURY DEMAND**

Plaintiffs demand a trial by jury.

DATED: November 30, 2007

ROBBINS UMEDA & FINK, LLP  
BRIAN J. ROBBINS  
MARC M. UMEDA  
STEVEN J. SIMERLEIN

By:   
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Co-Lead Counsel for Plaintiffs

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**BLUE COAT SYTEMS, INC. VERIFICATION**

I, Carolyn Adduci, hereby verify under the penalty of perjury that I am familiar with the allegations in the Verified Amended Consolidated Shareholder Derivative Complaint, and that I have authorized the filing of the Complaint, and that the foregoing is true and correct to the best of my knowledge, information and belief.

Date: 11-28-07

Carolyn Adduci  
Carolyn Adduci

**DECLARATION OF SERVICE**

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and a resident of the County of San Diego, over the age of 18 years, and not a party to or interest in the within action; that declarant's business address is 610 West Ash Street, Suite 1800, San Diego, California 92101.

2. That on November 30, 2007, I served the following document(s):

VERIFIED AMENDED CONSOLIDATED SHAREHOLDER DERIVATIVE  
COMPLAINT

in a United States mailbox at San Diego, California in a sealed envelope with postage thereon fully prepaid and addressed to the parties listed below and that there is a regular communication by mail between the place of mailing and the places so addressed.:

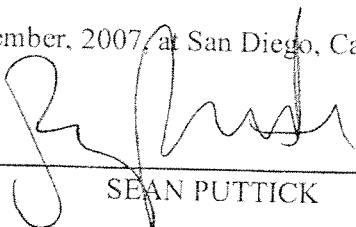
THE WEISER LAW FIRM, P.C.  
ROBERT B. WEISER  
121 N. Wayne Avenue, Suite 100  
Wayne, PA 19087  
Telephone: 610/225-2677  
Facsimile: 610/225-2678

LAW OFFICES OF BRUCE G. MURPHY  
BRUCE G. MURPHY  
265 Llwyds Lane  
Vero Beach, FL 32963  
Telephone: 828/737-0500  
Facsimile: 828/737-0534

by causing the following documents to be filed electronically with the Clerk of Court through ECF, and that ECF will send an e-notice of the electronic filing to the following:

robbins@ruflaw.com  
umeda@ruflaw.com  
ssimerlein@ruflaw.com  
ccostley@wsgr.com  
chashemi@wsgr.com  
jbirn@wsgr.com  
rmitchells@wsgr.com

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed this 30th day of November, 2007, at San Diego, California.

  
SEAN PUTTICK