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13 UNITED STATES DISTRICT COURT
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15 NORTHERN DISTRICT OF CALIFORNIA
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17 SAN JOSE DIVISION

18 SECURITIES AND EXCHANGE COMMISSION,
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20 Plaintiff,
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22 v.
23 HEADSPIN, INC.,
24
25 Defendant.

Case No. _____

COMPLAINT

26 Plaintiff Securities and Exchange Commission (“the Commission” or “the SEC”) alleges:

SUMMARY OF THE ACTION

27 1. From at least 2018 through 2020, HeadSpin, Inc. (“HeadSpin” or “Defendant”), a
28 Silicon Valley technology start-up, through its Chief Executive Officer, Manish Lachwani, engaged
in a fraudulent scheme to propel its valuation to over \$1 billion by falsely inflating the company’s
key financial metrics and doctoring its internal sales records. HeadSpin and its CEO then used these
inflated valuation and financial numbers to deceive investors into pouring approximately \$80 million
into the company between 2018 and 2020. The Commission has filed a separate action against

1 HeadSpin CEO Lachwani that is pending before this Court. Securities and Exchange Commission v.
2 Manish Lachwani, No. 3:21 Civ. 6554 (N.D. Cal.) (CRB).

3 2. HeadSpin made virtually all of its revenue by charging customers fees to use its
4 hardware and software products. To create the illusion of strong and consistent growth, HeadSpin's
5 CEO, who controlled all important aspects of HeadSpin's financials and sales operations, falsely
6 inflated the values of numerous customer deals that, in reality, were much smaller. HeadSpin's CEO
7 also fraudulently treated uncommitted deal amounts that he had discussed with customers as if they
8 were guaranteed future payments. He concealed this inflation by creating fake invoices and altering
9 real invoices to make it appear as though customers had been billed higher amounts.

10 3. HeadSpin's CEO's fraudulent actions increased the company's revenue-related
11 financial measures, which, in turn, fueled the company's valuation upward. In fall of 2018, ahead of
12 its Series B fundraising round, HeadSpin was valued at approximately half a billion dollars. Around
13 a year later, in fall of 2019, HeadSpin's valuation for its Series C fund raise had jumped to
14 approximately \$1.1 billion and entered so-called "unicorn" status.

15 4. HeadSpin's CEO knowingly or recklessly provided these lies about the company's
16 valuation and its seeming financial success to prospective investors. HeadSpin, through its CEO,
17 made numerous false statements that were designed to convince investors that HeadSpin had
18 hundreds of customers, including many of Silicon Valley's biggest and most high-profile companies,
19 signed up to long-term contracts totaling tens of millions of dollars per year. Investors invested
20 millions of dollars in HeadSpin based on these misrepresentations.

21 5. HeadSpin and its CEO's fraud unraveled in spring of 2020, following an internal
22 investigation. HeadSpin's CEO was forced to resign, and HeadSpin revised its valuation
23 dramatically downward from the \$1.1 billion claimed during the Series C round to approximately
24 \$300 million.

25 6. HeadSpin has violated the antifraud provisions of the federal securities laws.
26 Specifically, HeadSpin has violated 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C.
27 § 77q(a)] and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §
28 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

1 **II. HeadSpin, Through Its CEO, Engaged in a Fraudulent Scheme to Inflate Its Financials**
2 **in Order to Drive Up Its Valuation.**

3 19. Beginning at least in about 2018, HeadSpin, through its CEO, engaged in a fraudulent
4 scheme to inflate its financial records in order to achieve high valuations of the company that would
5 attract investors.

6 20. HeadSpin's CEO understood that the amount of the valuation depended, in large part,
7 on a key financial metric called "annual recurring revenue," or "ARR," as well as ARR growth over
8 time. ARR is a measure of the total revenue expected per year from committed customers with
9 signed contracts. The metric is commonly used by software companies like HeadSpin that charge
10 customers recurring fees to use their products. A growing ARR shows that a company is successfully
11 signing up new customers and/or expanding the deals it already has with existing customers.

12 21. HeadSpin's CEO inflated the company's ARR by falsely increasing the values of
13 several existing customer deals of all sizes, ranging from big deals with Silicon Valley heavyweights
14 to low dollar-value deals with smaller companies, and relying on uncommitted amounts from non-
15 binding agreements with other customers. HeadSpin's CEO entered the fabricated amounts into the
16 company's detailed ARR-tracking Spreadsheet that he alone controlled. For example, in about 2018,
17 HeadSpin's CEO sent an investor a version of the ARR Spreadsheet that claimed a reseller
18 ("Customer 1") was contributing approximately \$1 million in ARR. In reality, Customer 1 and
19 HeadSpin had signed a non-binding agreement that, among other things, set a maximum cap of
20 \$1.215 million on its purchases over two years from HeadSpin. Importantly, Customer 1 was not
21 obligated to pay anything until HeadSpin sent invoices at a later date. In the end, Customer 1 only
22 paid HeadSpin approximately \$500,000 over two years—far less than the maximum cap.

23 22. In other instances, HeadSpin's CEO fabricated or altered invoices to provide post-hoc
24 justifications to other HeadSpin employees for the inflated ARR amounts. For example, from 2018
25 through 2020, HeadSpin's CEO falsely claimed that a major San Francisco-based ride share company
26 ("Customer 2") had agreed to pay HeadSpin about \$1.44 million per year. In truth, Customer 2 made
27 a single purchase worth \$720,000 in 2018, and did not make a long-term commitment. To bridge the
28 gap between reality and his false claims, HeadSpin's CEO concocted a fake invoice covering the

1 remaining amount (*i.e.*, \$720,000) in 2018, and in 2019 he created two more fake invoices to
2 represent a supposed renewal of the full \$1.44 million.

3 23. In addition, HeadSpin's CEO falsely inflated the company's actual revenue numbers,
4 which were also shared with investors, using the same methods that he used to fabricate ARR.
5 HeadSpin's CEO dictated the inflated revenue numbers each quarter to HeadSpin's bookkeeper, who
6 recorded those numbers in the company's financial statements. He frequently sent the numbers
7 without supporting documentation (like contracts and invoices) notwithstanding the bookkeeper's
8 regular requests for such backup, and he sometimes sent her fake or altered invoices that he had
9 created, including the three fictional invoices related to Customer 2 and a doctored invoice related to
10 Customer 1.

11 24. On the strength of its fraudulently inflated ARR and other financial numbers,
12 HeadSpin achieved impressive valuations leading into its two fundraising rounds. In advance of the
13 Series B round in fall of 2018, HeadSpin was valued at approximately \$500 million. Around a year
14 later, at the start of its Series C round, HeadSpin had surged in valuation to approximately \$1.1
15 billion. HeadSpin's CEO falsely inflated the metrics, including ARR, in order to lure HeadSpin
16 investors into paying increasingly higher prices for HeadSpin's shares.

17 25. HeadSpin's CEO was able to carry out his fraudulent scheme for years because he
18 controlled and managed all the key aspects of HeadSpin's financials and sales operations, and he kept
19 HeadSpin employees in those different departments isolated from each other. For instance, virtually
20 all the information provided to HeadSpin's bookkeeper, including the supporting documentation for
21 claimed revenue amounts, flowed through HeadSpin's CEO.

22 26. By virtue of his control over the company, HeadSpin's CEO knew, or was reckless in
23 not knowing, that HeadSpin's ARR and other financial numbers were false and inflated. HeadSpin's
24 CEO had sole ownership of the ARR Spreadsheet and used it to personally calculate the company's
25 quarterly and yearly ARR. As HeadSpin's CEO admitted in a December 2017 email, he intended to
26 "super micro manage[]" the company's financials and finance function, and he rebuffed repeated
27 requests from late 2017 into 2020 from HeadSpin's board to hire a CFO to manage HeadSpin's day-
28 to-day finances. At the same time, HeadSpin's CEO knew, or was reckless in not knowing, about the

1 company's relationships with customers because he personally interacted and negotiated with many
2 of them, and he directly supervised the small staff of sales people who managed customer deals.

3 **III. HeadSpin, Through Its CEO, Lied to Series B Investors About Its Financials and**
4 **Customers.**

5 27. From August 2018 through October 2018, HeadSpin's CEO made numerous false and
6 misleading representations about HeadSpin's ARR, financials, and customer growth in connection
7 with the offer and sale of HeadSpin's preferred stock in the Series B round. In promoting the Series
8 B offering, HeadSpin's CEO knowingly or recklessly provided investors with the false impression
9 that HeadSpin was experiencing substantial growth in both its expected revenues and its number of
10 customers. HeadSpin's CEO personally met and communicated those misrepresentations to
11 prospective investors through emails, telephone calls, and in-person due diligence meetings. He also
12 directed his employees to include false information in written investor materials provided to
13 investors, including pitch decks, financial spreadsheets, and other promotional materials. The Series
14 B offering succeeded in raising approximately \$20 million from about 26 investors.

15 28. HeadSpin's CEO repeatedly knowingly or recklessly misrepresented HeadSpin's ARR
16 and ARR growth to Series B investors by sending them ARR numbers that he had falsely inflated.
17 He sent emails to investors in which he touted the inflated overall ARR for the company as well as
18 the grossly overstated ARRs for certain high-profile customers. HeadSpin's CEO also provided a
19 2018 Pitch Deck to Series B investors that, among other things, listed falsely inflated "revenue
20 commitment" amounts and growth percentages for specific big-name customers, including Customer
21 1 and Customer 2. In addition, HeadSpin's CEO provided certain large investors with versions of the
22 detailed ARR Spreadsheet, which also contained inflated ARR numbers for Customer 1, Customer 2,
23 and others.

24 29. HeadSpin's CEO sent those false ARR numbers even though he knew, or was reckless
25 in not knowing, that HeadSpin's ARR would be a focus of prospective investors, who would use it to
26 evaluate the extent to which the company's products were gaining traction with customers.
27 HeadSpin's CEO also knew, or was reckless in not knowing, that ARR, which is a widely used
28 metric in the software-subscription industry, was supposed to be calculated based on signed contracts

1 with committed customers. In fact, he told investors that HeadSpin’s ARR reflected signed customer
2 agreements with customers who had already been sent HeadSpin’s products and were able to use
3 them. Those representations were false and misleading.

4 30. HeadSpin’s CEO made additional misrepresentations to Series B investors beyond the
5 ARR numbers. HeadSpin’s CEO knowingly or recklessly sent financial statements to investors that
6 contained false and inflated revenues. He also promoted the inflated valuation. For instance, in an
7 August 2018 email to an investor, HeadSpin’s CEO touted that the company was “raising \$10m @
8 \$500m valuation.”

9 31. Relatedly, HeadSpin’s CEO also knew, or was reckless in not knowing, that Series B
10 investors would be impressed by HeadSpin’s purported roster of customers, which included some of
11 the largest and most recognizable technology companies in the world. But HeadSpin’s CEO
12 knowingly or recklessly included numerous companies on the list even though those companies had
13 terminated their relationships with HeadSpin or had declined to make a purchase after trying
14 HeadSpin’s products. For example, the 2018 Pitch Deck that HeadSpin’s CEO shared with Series B
15 investors falsely asserted that HeadSpin had experienced “No Customer Loss and Triple Digit
16 Growth.” In reality, HeadSpin had lost customers that decided to stop using HeadSpin’s services.
17 The 2018 Pitch Deck also included logos for at least 50 major companies, a number of which were
18 not active HeadSpin customers. For instance, the deck included the logo of a highly successful
19 Silicon Valley-based computer and cellphone manufacturer (“Customer 3”) even though Customer
20 3’s sole purchase expired more than a year earlier and was not renewed.

21 **IV. Misrepresentations Made by HeadSpin, Through Its CEO, Catapulted Its Valuation to**
22 **\$1.1 Billion During the Series C Funding Round.**

23 32. Less than a year after its successful Series B fund raise, HeadSpin conducted a Series
24 C fundraising round between August 2019 and February 2020 to offer and sell an additional \$60
25 million of its preferred stock. HeadSpin’s CEO’s scheme to fraudulently inflate the company’s ARR
26 and other financials had continued throughout 2019, and by the start of the Series C round,
27 HeadSpin’s CEO knowingly or recklessly told investors that HeadSpin would reach approximately
28 \$80 million of ARR by year end. The company’s impressive (but false) financials fueled a valuation

1 of approximately \$1.1 billion, a milestone that earned the startup “unicorn” status – a status touted by
2 HeadSpin’s CEO and noticed by investors. Ultimately, 29 investors purchased HeadSpin stock at
3 prices based on that inflated valuation.

4 33. As with the Series B round, HeadSpin’s CEO knowingly or recklessly made numerous
5 misrepresentations to Series C investors about ARR, revenue, and customer growth. HeadSpin’s
6 CEO continued to knowingly or recklessly claim falsely inflated ARRs for many customers,
7 including Customer 1 and Customer 2, in an updated version of the ARR Spreadsheet that he sent to
8 Series C investors. In fact, he increased the claimed ARRs for certain existing customers. For
9 example, according to the 2019 ARR Spreadsheet, a reseller (“Customer 4”), had ARR of over \$10
10 million. However, HeadSpin only received approximately \$1.4 million total in payments from
11 Customer 4 between 2018 and 2019. He also added inflated ARRs for new customers, including, for
12 instance, a major credit card company that signed a non-binding agreement with HeadSpin in 2019.
13 Separately, the financial statements that HeadSpin’s CEO provided to Series C investors contained
14 similarly inflated revenue numbers.

15 34. HeadSpin’s CEO also continued to knowingly or recklessly make misrepresentations
16 about HeadSpin’s retention of customers. In around September 2019, HeadSpin’s CEO sent a
17 prospective investor a version of the 2019 ARR Spreadsheet and knowingly or recklessly
18 misrepresented that HeadSpin had only lost two customers and that “[e]very other deal has expanded
19 or stayed the same.” He made those claims even though he knew, or was reckless in not knowing,
20 that many listed customers – including Customer 1, Customer 2, and Customer 4 – had paid
21 HeadSpin far less than the amounts claimed in the ARR Spreadsheet. As another example,
22 HeadSpin’s CEO reviewed a draft investment memorandum put together by one of the company’s
23 existing investors in anticipation of the Series C round. He knowingly or recklessly confirmed the
24 accuracy of the memorandum even though it incorrectly identified Customer 3, which had ended its
25 relationship with HeadSpin in 2017, as part of the company’s “impressive customer base.”

26 35. The grossly overstated ARR, revenues, and customer lists were important to investors
27 who participated in HeadSpin’s two offerings between 2018 and 2020 because those metrics were
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1 directly related to the future growth and success of HeadSpin’s business and, thus, the likelihood that
2 investors would obtain a return on their investments in the company.

3 **V. HeadSpin and Its CEO’s Fraud Unraveled When Its ARR Inflation Came to Light.**

4 36. In March 2020, the company’s Board of Directors was alerted to concerns about the
5 accuracy of the financial and customer information provided to investors and discovered, through an
6 investigation, significant issues with HeadSpin’s reporting of customer deals. HeadSpin then
7 determined, based on a subsequent review of its financial information, that HeadSpin’s ARR at the
8 end of 2019 was closer to \$10 million, as opposed to the \$80 million represented to investors.

9 37. In May 2020, HeadSpin forced its CEO to resign.

10 38. HeadSpin revised its valuation from approximately \$1.1 billion down to
11 approximately \$300 million. The company also returned approximately 70% of principal to investors
12 in the Series B and C funding rounds through a recapitalization process. The company further
13 offered to return the remaining funds in the form of promissory notes with one percent interest.
14 Approximately 31 investors chose to retain their HeadSpin stock instead of exchanging for
15 promissory notes.

16 39. In addition, HeadSpin’s remedial efforts included hiring new senior management,
17 including a new CEO, COO, GC, and Controller; expanding its board; and adopting new processes
18 and procedures designed to ensure transparency and accuracy of deal reporting and associated
19 revenues.

20 **FIRST CLAIM FOR RELIEF**

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

22 40. The Commission realleges and incorporates by reference paragraphs 1 through 39.

23 41. Defendant, by engaging in the conduct described above, directly or indirectly, in
24 connection with the purchase or sale of securities, by use of means or instrumentalities of interstate
25 commerce, or of the mails, with scienter:

26 a. Employed devices, schemes, or artifices to defraud;

- b. Made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and
- c. Engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon other persons, including purchasers of securities.

42. By reason of the foregoing, Defendant violated, and unless restrained and enjoined will continue to violate, Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

SECOND CLAIM FOR RELIEF

(Violations of Section 17(a) of the Securities Act)

43. The Commission realleges and incorporates by reference paragraphs 1 through 39.

44. Defendant, by engaging in the conduct described above, directly or indirectly, in the offer or sale of securities, by use of the means or instruments of transportation or communication in interstate commerce or by use of the mails,

- a. with scienter, employed devices, schemes, or artifices to defraud;
- b. obtained money or property by means of untrue statements of material fact or by omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and
- c. engaged in transactions, practices, or courses of business which operated or would operate as a fraud or deceit upon purchasers.

45. By reason of the foregoing, Defendant violated, and unless restrained and enjoined will continue to violate, Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)].

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that the Court:

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I.

Enter an order permanently enjoining Defendant from directly or indirectly violating Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5] thereunder, and Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)].

II.

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

III.

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

Dated: January 28, 2022

Respectfully submitted,

/s/ David Zhou
David Zhou
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Attorneys for Plaintiff
SECURITIES AND EXCHANGE COMMISSION