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12 **UNITED STATES DISTRICT COURT**  
13 **NORTHERN DISTRICT OF CALIFORNIA**

14 KIMBERLY QUACO, et al., Derivatively on )  
15 Behalf of Nominal Defendant POWER, )  
INTEGRATIONS, INC., )  
16 )  
17 Plaintiffs, )  
18 vs. )  
19 BALU BALAKRISHNAN, DEREK BELL, ALAN )  
D. BICKELL, NICHOLAS E. BRATHWAITE, )  
20 R. SCOTT BROWN, JOHN M. COBB, )  
21 RODERICK D. DAVIES, HOWARD F. )  
EARHART, BALAKRISHNAN S. IYER, )  
22 E. FLOYD KVAMME, BRUCE RENOUEARD, )  
VLADIMIR RUMENNIK, DANIEL M. )  
23 SELLECK, ROBERT G. STAPLES, JOHN )  
TOMLIN, CLIFFORD J. WALKER, STEVEN J. )  
24 SHARP, ROBERT J. LELIEUR, THOMAS W. )  
25 ROESLER, RICHARD S. FASSLER, )  
ANDREW MORRISH, and JIM FIEBIGER )

Case No. C-06-2811

**AMENDED CONSOLIDATED  
SHAREHOLDER DERIVATIVE  
COMPLAINT**

26 Defendants, )  
27 )  
28 )

**JURY TRIAL DEMANDED**



1 for stock option grants to PI executives based on a twenty-day trading window following the date of  
2 grant was 638%. This is more than seven times the average annualized investor return of 90% over the  
3 same period. The difference of 548% in averaged annualized returns is strong evidence of backdating.

4 4. By engaging in this scheme, the Individual Defendants (as defined herein) were able to  
5 conceal that PI was not recording material compensation expenses and was materially overstating the  
6 Company's net income and earnings for at least 1998 through 2006. Moreover, from 1998 through  
7 2006, the Individual Defendants collectively realized over \$97 million in illicit proceeds through the  
8 sale of PI stock based on their knowledge of material non-public information regarding the illegal  
9 backdated scheme. By contrast, PI has suffered, and will continue to suffer, significant financial and  
10 non-monetary damages and injuries, several of which were identified in a report issued by the Center  
11 for Financial Research and Analysis on May 16, 2006, entitled "Options Backdating – Which  
12 Companies Are at Risk?":

- 13 • SEC investigation risk – The SEC has begun information investigations at many  
14 companies in recent months and has also begun to call for improved disclosures  
around all areas of executive compensation.
- 15 • Accounting restatement risk – Some companies which have admitted backdating  
16 options have accompanied those admissions with financial restatements impacting  
both the balance sheet and earnings.
- 17 • Tax/Cash implications – The change in options from the practice of options  
18 backdating may force some companies to restate tax positions for the years in  
question, which could result in an obligation to pay back taxes.
- 19 • Management credibility risk – If a reputable management team is found to have  
20 repeatedly backdated options, thereby enriching themselves at the expense of  
shareholder, the reputation of management (and the related stock premium for  
superior management) could take a hit.

21 5. PI has already begun to experience a majority of the risks noted in the Center for  
22 Financial Research and Analysis report. PI is embroiled in an SEC investigation that the Company  
23 announced on May 24, 2006. PI has announced that the Company's financial statements for fiscal years  
24 ended 1999 through 2004 and the first three quarters of 2005 cannot be relied upon, and will need to be  
25 restated. PI's Chairman of the Board, defendant Howard Earhart, and Chief Financial Officer,  
26 defendant John Cobb, resigned from their positions as a result of the revelations of the Individual  
27 Defendants' backdating scheme.  
28

1           6.       The Individual Defendants’ backdating scheme not only illegally lined the Individual  
2 Defendants’ pockets and caused PI to issue materially false financial statements, but undermined the  
3 key purpose of stock option-based executive compensation: to provide incentive to improve the  
4 Company’s performance and increase the Company’s stock price and market capitalization. By  
5 manipulating options such that they carried a strike price lower than the trading price of the stock on the  
6 date of grant, PI insiders profited immediately upon the award of the options without doing anything to  
7 improve the Company’s business or financial condition.

8           7.       Moreover, PI has *admitted* to the egregious misconduct complained of herein.  
9 Specifically, in a May 5, 2006 press release, PI *admitted that “the actual dates of measurement for*  
10 *certain past stock option grants differed from the recorded grant dates for such awards.”* (emphasis  
11 added).

12           8.       In addition, Citigroup issued a report in May 2006 which identified through a statistical  
13 analysis certain companies in the semiconductor industry and in the broader cross technology sector  
14 that analysts believed were at risk of being embroiled in the options backdating scandal. That report,  
15 based on historical stock option granting data, found that PI was statistically the company *most likely to*  
16 *have manipulated its stock option grants* out of thirty companies analyzed.

17           9.       In sum, in gross breach of their fiduciary duties as officers and/or directors of PI, the  
18 Individual Defendants colluded with one another to:

- 19           a.       improperly backdate grants of PI stock options to PI officers and  
20                   directors, in violation of the Company’s shareholder-approved stock  
                    option plans;
- 21           b.       improperly record and account for the backdated stock options, in  
22                   violation of Generally Accepted Accounting Principles;
- 23           c.       improperly take tax deductions based on the backdated stock options, in  
24                   violation of Section 162(m) of the Internal Revenue Code; and
- 25           d.       produce and disseminate to PI shareholders and the market false  
26                   financial statements and other SEC filings that improperly recorded and  
27                   accounted for the backdated option grants and concealed the improper  
28                   backdating of stock options.



1 17. Defendant Steven J. Sharp (“Sharp”) is a co-founder of PI and has been a director of the  
2 Company since 1988. Upon Howard F. Earhart’s resignation as Chairman of the Board in 2006, Sharp  
3 assumed the position of Chairman of the Board.

4 18. Defendant E. Floyd Kvamme (“Kvamme”) has served as a director of PI since 1989.  
5 Kvamme has served as a member of both the Compensation and Equity Award Committee (previously  
6 known as the Compensation Committee) of the Board (the “Compensation Committee”) and the Audit  
7 Committee of the Board (the “Audit Committee”) at all times relevant hereto.

8 19. Defendant Alan D. Bickell (“Bickell”) has served as a director of PI and as a member of  
9 both the Compensation Committee and the Audit Committee since 1999.

10 20. Defendant R. Scott Brown (“Brown”) has served as a director of PI and as a member of  
11 the Compensation Committee since 1999.

12 21. Defendant Nicholas E. Brathwaite (“Brathwaite”) has served as a director of PI since  
13 2000. Brathwaite served as a member of the Audit Committee from 2000 to 2004.

14 22. Defendant Balakrishnan S. Iyer (“Iyer”) has served as a director of PI and as a member  
15 of the Audit Committee since 2004.

16 23. Defendant Balu Balakrishnan (“Balakrishnan”) has served as a director of PI and as  
17 President and CEO of PI since January 2002. From 1994 to 2002 Balakrishnan served in various  
18 executive positions with the Company, including Vice President of Engineering and Marketing.  
19 Furthermore, PI has paid Balakrishnan the following compensation since his promotion to CEO:<sup>3</sup>

<b>Defendant</b>	<b>Fiscal Year</b>	<b>Salary</b>	<b>Bonus</b>	<b>Other Annual Compensation</b>	<b>All Other Compensation</b>
Balakrishnan	2005	\$347,500	\$217,332	\$3,000	\$5,963
	2004	\$339,769	\$110,833	\$3,000	\$6,830
	2003	\$324,846	\$273,333	\$3,000	\$1,380
	2002	\$316,019	\$210,432	-	\$759

24 24. Defendant Jim Fiebiger (“Fiebiger”) has served as a director of PI since March 2006.  
25  
26

27 <sup>3</sup> Compensation information for the 2006 fiscal year is unavailable.  
28



1 38. Defendant Andrew Morrish (“Morrish”) served as PI’s Vice President of Strategic  
2 Marketing and Applications from August 2002 to 2005.

3 39. Collectively, defendants Earhart, Sharp, Bickell, Brathwaite, Kvamme, Brown,  
4 Balakrishnan, Cobb, Walker, Rumennik, Selleck, Staples, Davies, Bell, Tomlin, Renouard, Lelieur,  
5 Roesler, Fassler and Morrish are referred to herein as the “Option Recipient Defendants.”

6 **Individual Defendants**

7 40. Collectively, the Option Recipient Defendants and Director Defendants are referred to  
8 herein as the “Individual Defendants.”

9 **DUTIES OF THE INDIVIDUAL DEFENDANTS**

10 41. By reason of their positions as officers and/or directors of the Company and because of  
11 their ability to control the business and corporate affairs of the Company, the Individual Defendants  
12 owed the Company and its shareholders the fiduciary obligations of good faith, trust, loyalty, and due  
13 care, and were and are required to use their utmost ability to control and manage the Company in a fair,  
14 just, honest, and equitable manner. The Individual Defendants were and are required to act in  
15 furtherance of the best interests of the Company and its shareholders so as to benefit all shareholders  
16 equally and not in furtherance of their personal interest or benefit. Each director and officer of the  
17 Company owes to the Company and its shareholders the fiduciary duty to exercise good faith and  
18 diligence in the administration of the affairs of the Company and in the use and preservation of its  
19 property and assets, and the highest obligations of fair dealing.

20 42. The Individual Defendants, because of their positions of control and authority as  
21 directors and/or officers of the Company, were able to and did, directly and/or indirectly, exercise  
22 control over the wrongful acts complained of herein.

23 43. To discharge their duties, the officers and directors of the Company were required to  
24 exercise reasonable and prudent supervision over the management, policies, practices and controls of  
25 the Company. By virtue of such duties, the officers and directors of the Company were required to,  
26 among other things:

- 1 a. exercise good faith in ensuring that the affairs of the Company were  
2 conducted in an efficient, business-like manner so as to make it possible  
3 to provide the highest quality performance of its business;
- 4 b. exercise good faith in ensuring that the Company was operated in a  
5 diligent, honest and prudent manner and complied with all applicable  
6 federal and state laws, rules, regulations and requirements, including  
7 acting only within the scope of its legal authority;
- 8 c. exercise good faith in supervising the preparation, filing and/or  
9 dissemination of financial statements, press releases, audits, reports or  
10 other information required by law, and in examining and evaluating any  
11 reports or examinations, audits, or other financial information  
concerning the financial condition of the Company;
- 12 d. exercise good faith in ensuring that the Company's financial statements  
13 were prepared in accordance with Generally Accepted Accounting  
14 Principles ("GAAP"); and
- 15 e. refrain from unduly benefiting themselves and other Company insiders  
16 at the expense of the Company.

17 44. The Individual Defendants, particularly the members of the Audit Committee, were  
18 responsible for maintaining and establishing adequate internal accounting controls for the Company and  
19 to ensure that the Company's financial statements were based on accurate financial information.  
20 According to GAAP, to accomplish the objectives of accurately recording, processing, summarizing,  
21 and reporting financial data, a corporation must establish an internal accounting control structure.  
22 Among other things, the Individual Defendants were required to:

- 23 (1) make and keep books, records, and accounts, which, in reasonable  
24 detail, accurately and fairly reflect the transactions and dispositions of  
25 the assets of the issuer; and
- 26 (2) devise and maintain a system of internal accounting controls sufficient  
27 to provide reasonable assurances that –
  - 28 (a) transactions are executed in accordance with management's  
general or specific authorization;
  - (b) transactions are recorded as necessary to permit preparation of  
financial statements in conformity with [GAAP].

45. PI's Audit Committee Charter provides that the Audit Committee shall, among other  
things:

- a. Review and discuss with management and the independent auditor  
any certification, report, opinion or review rendered by the  
independent auditor, and recommend to the Board whether the

1 audited financial statements should be included in the Company's  
2 annual report on Form 10-K;

3 b. Review and discuss earnings press releases and other information  
4 provided to securities analysts and ratings agencies, including any  
5 "pro forma" or adjusted financial information;

6 c. Review with management its assessment of the effectiveness and  
7 adequacy of the Company's internal control structure and procedures  
8 for financial reporting ("Internal Controls"), review annually with the  
9 independent auditor the attestation to and report on the assessment  
10 made by management, and consider with management, the internal  
11 auditors and the independent auditor whether any changes to the  
12 Internal Controls are appropriate in light of management's assessment  
13 or the independent auditor's attestation;

14 d. Review with the chief executive and chief financial officer of the  
15 company any report on significant deficiencies in the design or  
16 operation of the Internal Controls that could adversely affect the  
17 Company's ability to record, process, summarize or report financial  
18 data, any material weaknesses in Internal Controls identified to the  
19 auditors, and any fraud, whether or not material, that involves  
20 management or other employees who have a significant role in the  
21 Company's Internal Controls; and

22 e. Prepare the report required by the rules of the SEC to be included in  
23 the Company's annual proxy statement.

24 46. PI's Compensation Committee Charter provides that the Compensation Committee shall,  
25 among other things:

26 a. With respect to the Chief Executive Officer:

27 1) Determine all compensation, including incentive-based  
28 compensation and equity compensation awards;

1) Develop or review annual performance objectives and goals  
relevant to compensation and awards, for the Chief Executive  
Officer and evaluate the performance of the Chief Executive  
Officer in light of these goals and objectives; and

2) Consider, in determining the incentive component for the Chief  
Executive Officer, the Company's performance and relative  
shareholder return, the value of similar incentive awards to chief  
executive officers at comparable companies, and the awards  
given to the Company's Chief Executive Officer in past years.

b. Review incentive-based compensation plans in which the Company's  
executive officers participate, and determine the salaries, incentive  
and equity compensation for executive officers, and oversee the  
evaluation of management;

- 1 c. Propose the adoption, amendment, and termination of stock option  
2 plans, stock appreciation rights plans, pension and profit sharing  
3 plans, stock bonus plans, stock purchase plans, bonus plans, deferred  
compensation plans, and other similar programs (“Compensation  
Plans”);
- 4 d. Approve and periodically review the salary and equity award ranges  
5 for non-executive officers and other employees of the Company, and  
6 authorize the Chief Executive Officer to approve compensation levels  
for such non-executive officers and other employees of the Company  
within such ranges;
- 7 e. Determine all compensation to be paid to the non-employee directors  
8 of the Company for their service on the Board and its committees,  
9 other than compensation received pursuant to automatic equity award  
grants under stockholder approved equity compensation plans; and
- 10 f. Prepare and annual report on executive compensation and awards for  
11 inclusion in the Company’s proxy statement for the annual meeting of  
stockholders, in accordance with applicable rules and regulations.

12 **FACTUAL ALLEGATIONS**

13 **Backdating of Stock Option Grants to the Option Recipient Defendants**

14 47. Pursuant to the terms of the Company’s shareholder-approved 1997 Stock Option Plan  
15 (as amended) (the “Plan”), the “Fair Market Value” of PI stock is defined as “the closing sale price of a  
16 share of Stock . . . as quoted on the Nasdaq National Market, the Nasdaq Small-Cap Market or such  
17 other national or regional securities exchange or market system constituting the primary market for the  
18 Stock,” and the exercise price of options granted pursuant to the Plan “shall be not less than the Fair  
Market Value of a share of Stock on the effective date of grant of the Option.”

19 48. Pursuant to Accounting Principles Board Opinion No. 25, ‘Accounting for Stock Issued  
20 to Employees’ (‘APB 25’), the applicable GAAP provision at the time of the stock option grants alleged  
21 herein, if the market price on the date of grant exceeds the exercise price of the options, the company  
22 must recognize the difference as an expense.

23 49. Pursuant to Section 162(m) of the Internal Revenue Code, 26 U.S.C. § 162(m) (“Section  
24 162(m)”), compensation in excess of \$1 million per year, including gains on stock options, paid to a  
25 corporation’s five most highly-compensated officers is tax deductible only if: (i) the compensation is  
26 payable solely on account of the attainment of one or more performance goals; (ii) the performance  
27 goals are determined by a compensation committee comprised solely of two or more outside directors,  
28

1 (iii) the material terms under which the compensation is to be paid, including the performance goals, are  
2 disclosed to shareholders and approved by a majority of the vote in a separate shareholder vote before  
3 the payment of the compensation, and (iv) before any payment of such compensation, the compensation  
4 committee certifies that the performance goals and any other material terms were in fact satisfied.

5 50. According to the Company's proxy statements and the Compensation Committee  
6 Charter, at all times relevant hereto the Compensation Committee determined the salaries, incentive  
7 compensation, and stock option awards for executive officers of PI and administered the Company's  
8 stock option plans.

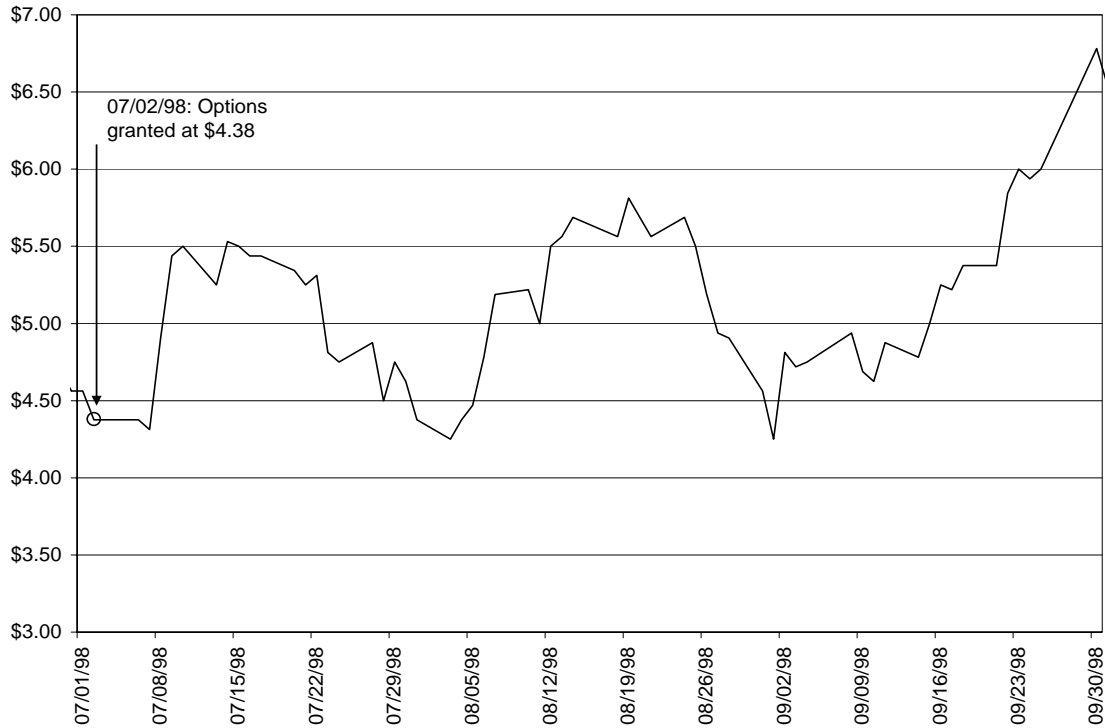
9 51. From 1998 to 2002, the Compensation Committee, which consisted of defendants  
10 Kvamme, Bickell and Brown, with the knowledge and approval of the other members of the Board,  
11 knowingly and deliberately violated the terms of the Plans, APB 25 and Section 162(m) by knowingly  
12 and deliberately backdating grants of stock options to make it appear as though the grants were made on  
13 dates when the market price of PI stock was lower than the market price on the actual grant dates,  
14 thereby unduly benefiting the recipients of the backdated options.

15 52. The members of the Board who were not on the Compensation Committee had actual  
16 knowledge of the backdating and knew that it violated the terms of the Plans, ABP 25 and Section  
17 162(m). As members of the Compensation Committee, Kvamme, Bickell and Brown, in particular,  
18 knew that the option grants to them were not actually granted on those days. All of the members of the  
19 Board knew that the publicly reported grant dates and statements that the Company followed APB 25  
20 and granted options with exercise prices equal to the fair market value of PI stock on the date of grant  
21 were false because the grants were in fact backdated. The entire Board knowingly and deliberately  
22 approved the backdating scheme with knowledge of its consequences, e.g., its effects on PI's financial  
23 statements.

24 **1998 Stock Option Grants**

25 53. Purportedly on July 2, 1998, the Compensation Committee, which included defendant  
26 Kvamme, granted a total of over 180,000 stock options to seven of the Option Recipient Defendants,  
27 including former President and CEO Earhart and five of the Company's other most highly compensated  
28

1 executives as disclosed in PI's proxy statement. These stock options were backdated to coincide with  
 2 one of the lowest closing prices of PI stock for the fiscal quarter, as demonstrated below:<sup>4</sup>

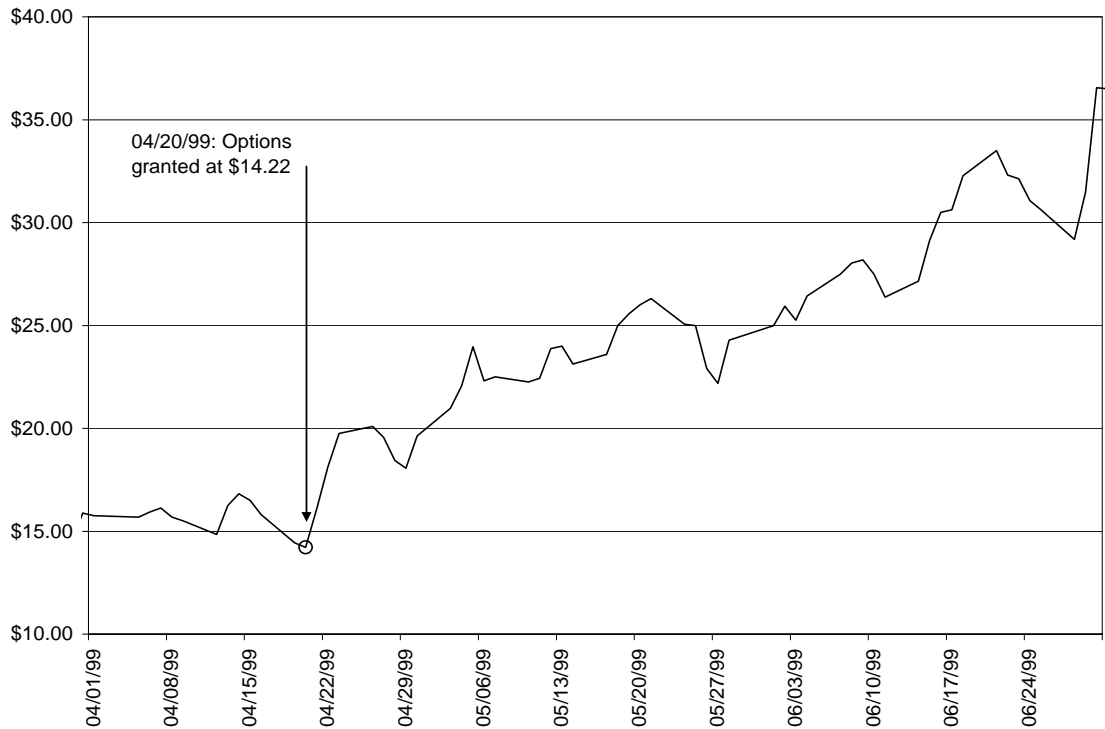


Purported Date of Grant	Name	Exercise Price	Number of Stock Options	Adjusted Exercise Price	Adjusted Number of Stock Options
07/02/98	Earhart	\$8.75	50,000	\$4.38	100,000
	Balakrishnan	\$8.75	30,000	\$4.38	60,000
	Walker	\$8.75	25,000	\$4.38	50,000
	Rumennick	\$8.75	25,000	\$4.38	50,000
	Selleck	\$8.75	25,000	\$4.38	50,000
	Staples	\$8.75	25,000	\$4.38	50,000
	Lelieur	\$8.75	3,150	\$4.38	6,300

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 23  
 24  
 25 <sup>4</sup> All graphs in the Complaint use exercise prices and closing prices adjusted for the Company's 2-for-1  
 26 stock split effective November 23, 1999. The tables following the graphs detail both the original  
 27 exercise prices and number of stock options granted and the adjusted exercise prices and adjusted  
 28 number of stock options granted.

**1999 Stock Option Grants**

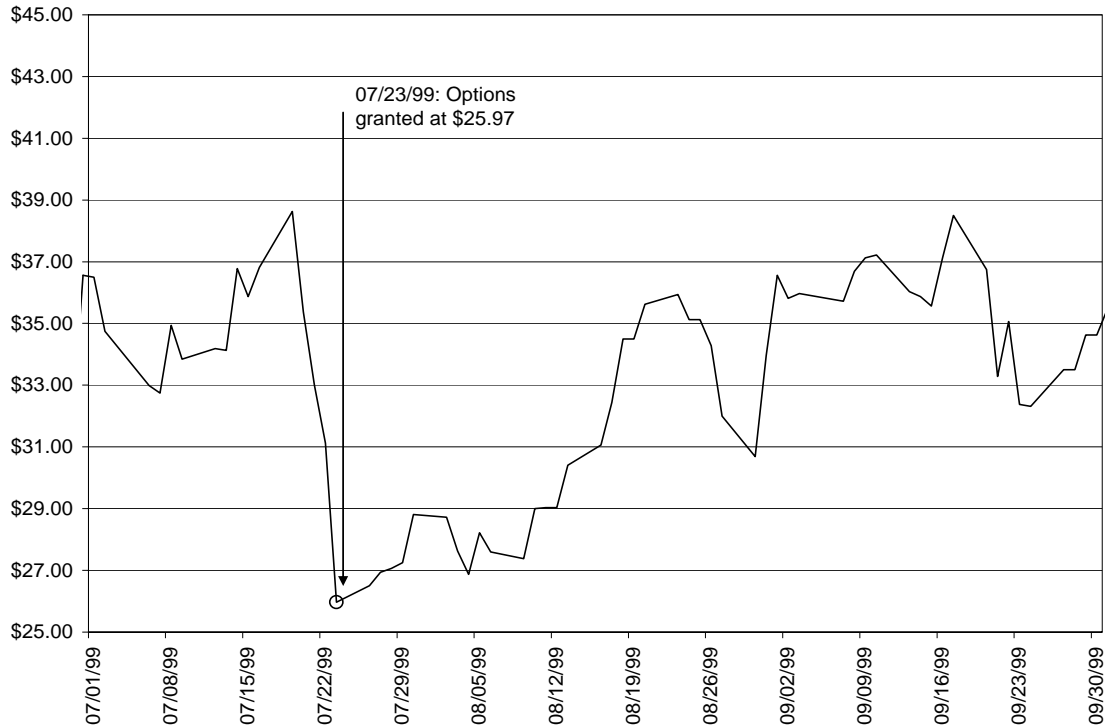
54. Purportedly on April 20, 1999, the Compensation Committee, which included defendants Kvamme and Bickell, granted a total of over 225,000 stock options to six of the Option Recipient Defendants, including former President and CEO Earhart and four of the Company’s other most highly compensated executives as disclosed in PI’s proxy statement. These stock options were backdated to coincide with *the lowest closing prices of PI stock for the fiscal quarter*, as demonstrated below:



Purported Date of Grant	Name	Exercise Price	Number of Stock Options	Adjusted Exercise Price	Adjusted Number of Stock Options
04/20/99	Earhart	\$28.44	75,000	\$14.22	150,000
	Balakrishnan	\$28.44	40,000	\$14.22	80,000
	Selleck	\$28.44	40,000	\$14.22	80,000
	Rumennick	\$28.44	40,000	\$14.22	80,000
	Walker	\$28.44	31,200	\$14.22	62,400
	Lelieur	\$28.44	4,000	\$14.22	8,000

55. Purportedly on July 23, 1999, the same day that Dr. William Davidow, who had been a member of the Compensation Committee, resigned as a director, the Compensation Committee, now consisting of defendants Kvamme, Bickell and Brown, granted defendants Brown and Davies 22,500

1 stock options. These stock options were backdated to coincide with the *lowest closing price of PI*  
 2 *stock for the fiscal quarter*, as demonstrated below:

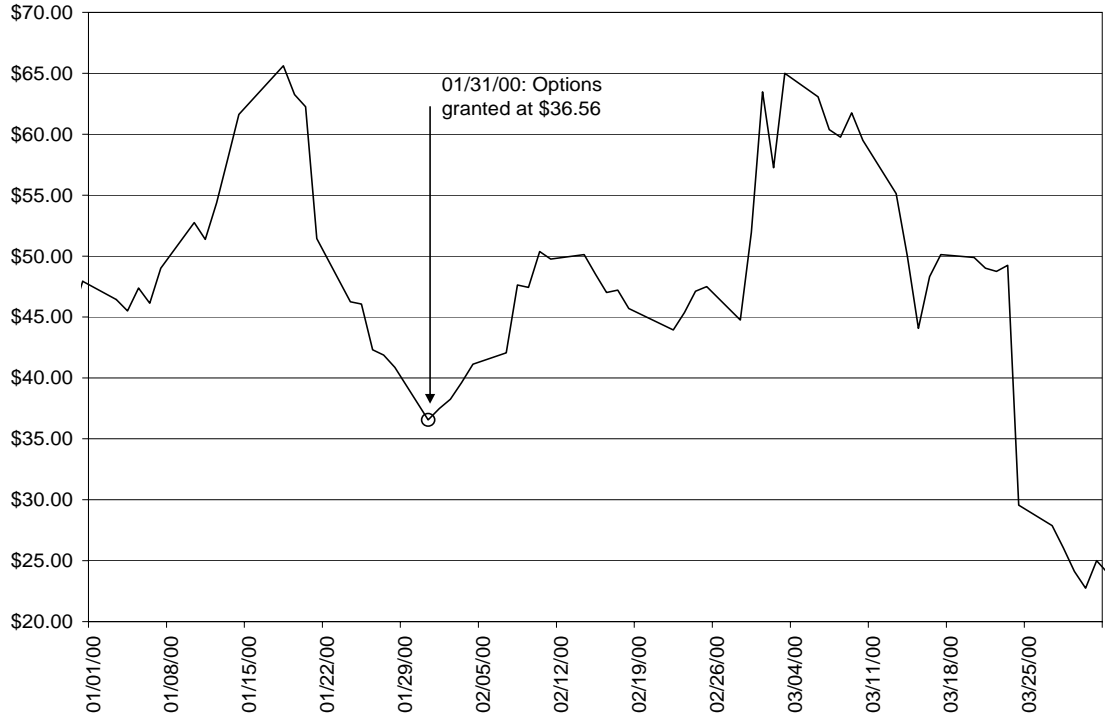


Purported Date of Grant	Name	Exercise Price	Number of Stock Options	Adjusted Exercise Price	Adjusted Number of Stock Options
07/23/99	Davies	\$51.94	7,500	\$25.97	15,000
	Brown	\$51.94	15,000	\$25.97	30,000

**2000 Stock Option Grants**

56. Purportedly on January 31, 2000, the Compensation Committee, which consisted of defendants Kvamme, Bickell and Brown, granted 30,000 stock options to defendant Braithwaite. These stock options were backdated to coincide with one of the lowest closing prices of PI stock for the fiscal quarter and the *lowest closing price of PI stock for the months of January and February*, as demonstrated below:

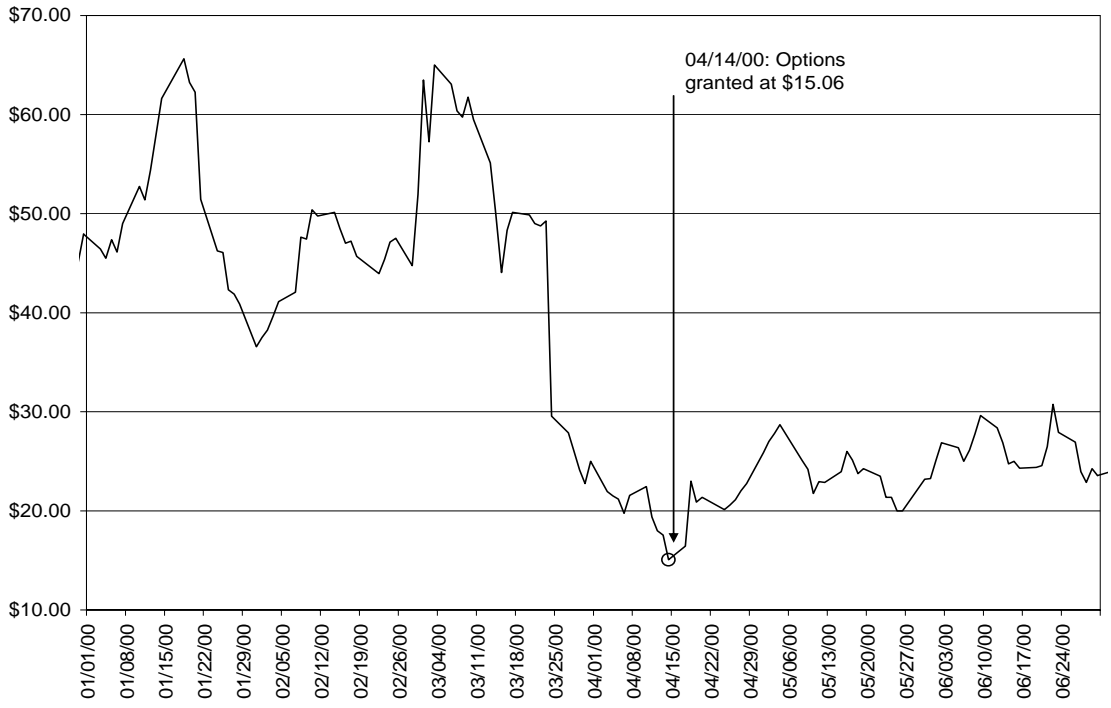
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Purported Date of Grant	Name	Exercise Price	Number of Stock Options
01/31/00	Brathwaite	\$36.56	At least 30,000

57. Purportedly on April 14, 2000, the Compensation Committee, which consisted of defendants Kvamme, Bickell and Brown, granted a total of at least 345,000 stock options to eight of the Option Recipient Defendants, including former President and CEO Earhart and four of the Company’s other most highly compensated executives as disclosed in PI’s proxy statement. These stock options were backdated to coincide with *the lowest closing prices of PI stock for the fiscal quarter and first half of the fiscal year*, as demonstrated below:

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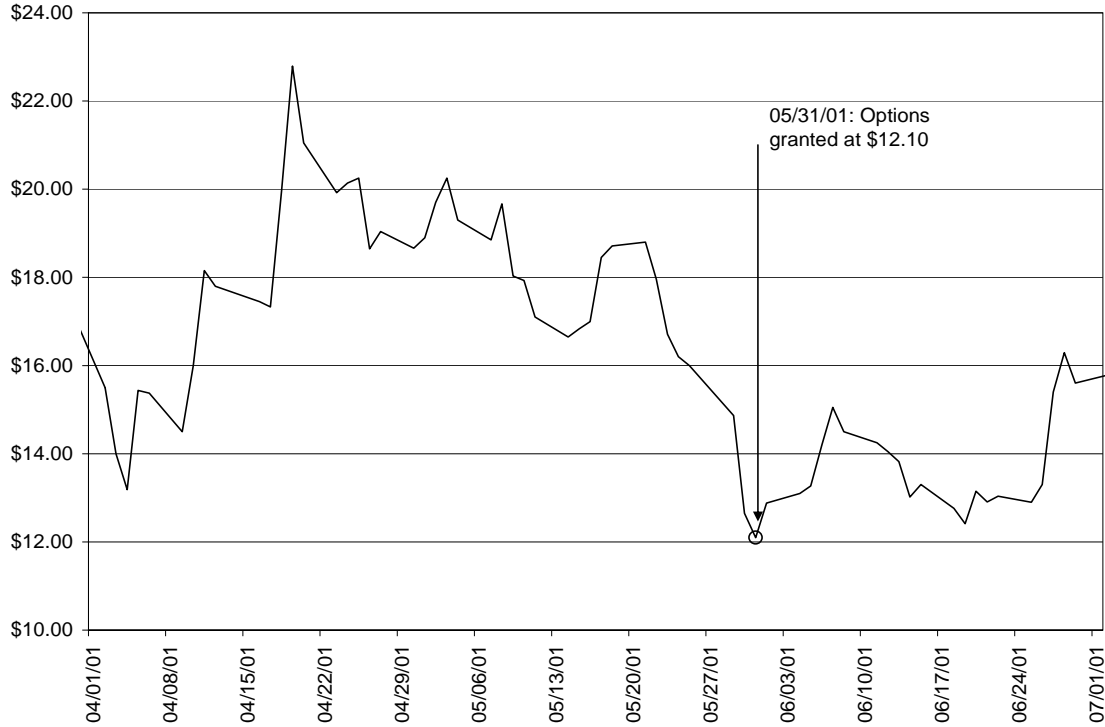


Purported Date of Grant	Name	Exercise Price	Number of Stock Options
04/14/00	Earhart	\$15.06	80,000
	Balakrishnan	\$15.06	80,000
	Rumennick	\$15.06	40,000
	Selleck	\$15.06	45,000
	Davies	\$15.06	30,000
	Fassler	\$15.06	At least 25,000
	Walker	\$15.06	30,000
	Lelieur	\$15.06	15,000

**2001 Stock Option Grants**

58. Purportedly on May 31, 2001, the Compensation Committee, which consisted of defendants Kvamme, Bickell and Brown, granted a total of at least 945,000 stock options to twelve of the Option Recipient Defendants, including all three members of the Compensation Committee and four of the Company’s five most highly compensated executives as disclosed in PI’s proxy statement. These stock options were backdated to coincide with *the lowest closing prices of PI stock for the fiscal quarter*, as demonstrated below:

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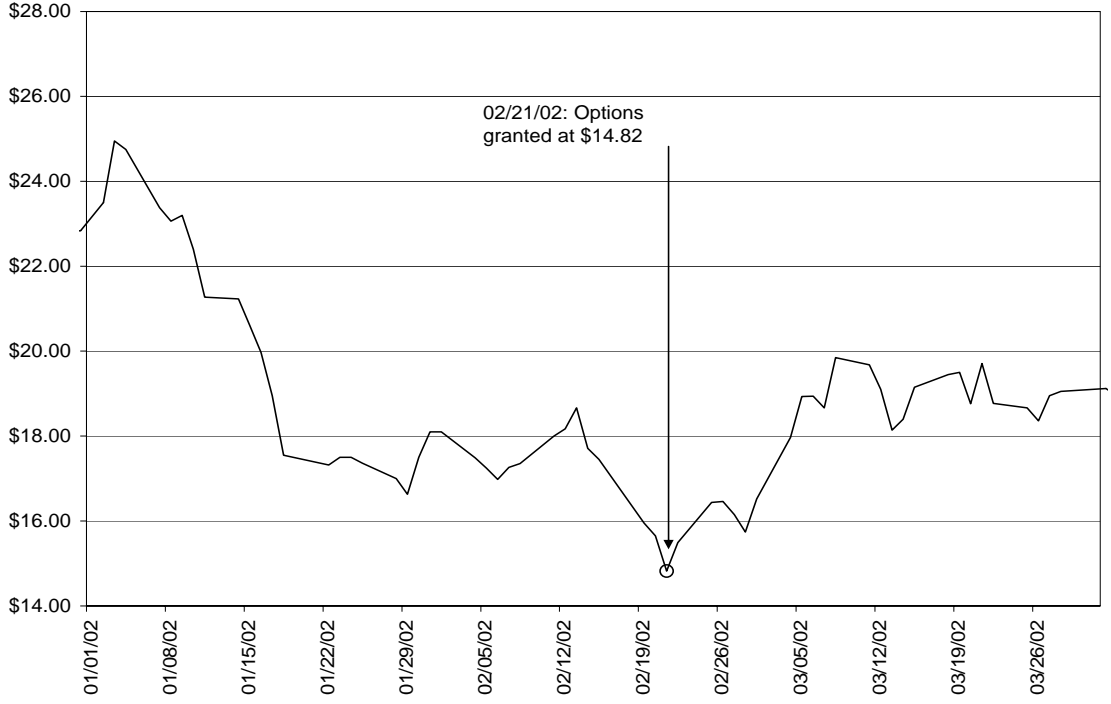


Purported Date of Grant	Name	Exercise Price	Number of Stock Options
05/31/01	Earhart	\$12.10	125,000
	Balakrishnan	\$12.10	300,000
	Walker	\$12.10	35,000
	Selleck	\$12.10	45,000
	Bickell	\$12.10	15,000
	Bell	\$12.10	175,000
	Cobb	\$12.10	140,000
	Brathwaite	\$12.10	15,000
	Roesler	\$12.10	50,000
	Sharp	\$12.10	15,000
	Kvamme	\$12.10	15,000
	Brown	\$12.10	15,000

**2002 Stock Option Grants**

59. Purportedly on February 21, 2002, the Compensation Committee, which consisted of defendants Kvamme, Bickell and Brown, granted a total of more than 525,000 stock options to six of the Option Recipient Defendants, including all five of the Company’s most highly compensated executives as disclosed in PI’s proxy statement. These stock options were backdated to coincide with *the lowest closing prices of PI stock for the fiscal quarter*, as demonstrated below:

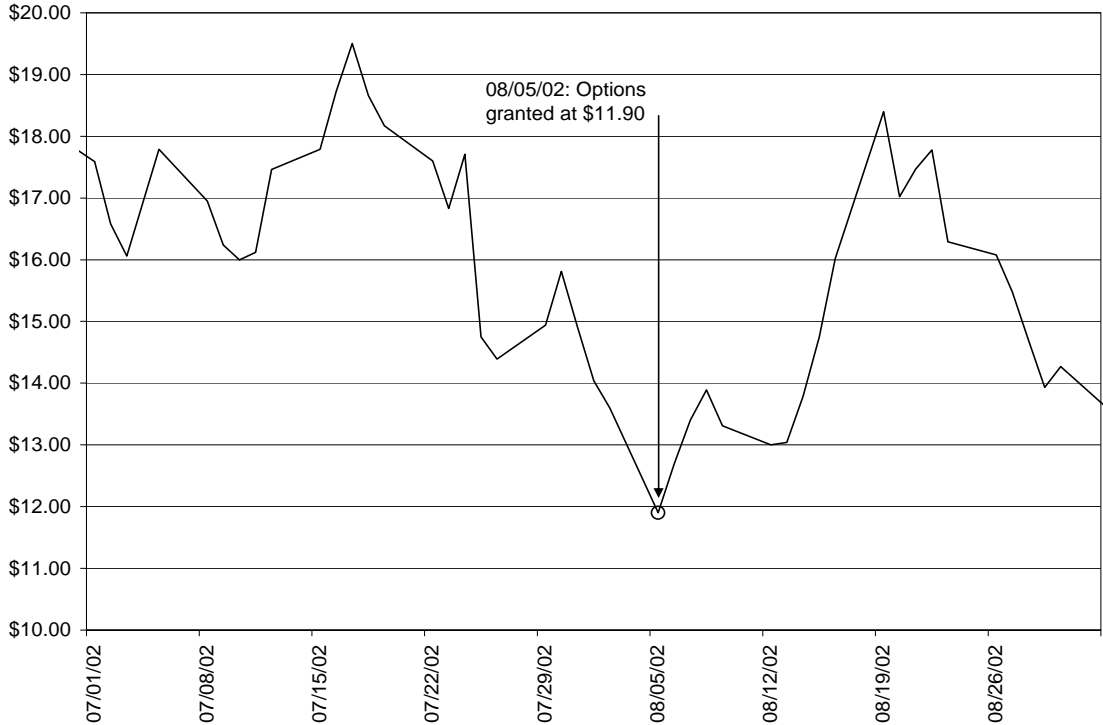
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Purported Date of Grant	Name	Exercise Price	Number of Stock Options
02/21/02	Balakrishnan	\$14.82	200,000
	Walker	\$14.82	65,000
	Selleck	\$14.82	50,000
	Tomlin	\$14.82	25,000
	Bell	\$14.82	40,000
	Renouard	\$14.82	150,000

60. Purportedly on August 5, 2002, the Compensation Committee, which consisted of defendants Kvamme, Bickell and Brown, granted defendant Morrish a total of at least 134,000 stock options. These stock options were backdated to coincide with *the lowest closing prices of PI stock for the months of July and August*, as demonstrated below:

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Purported Date of Grant	Name	Exercise Price	Number of Stock Options
08/05/02	Morrish	\$11.90	At least 134,367

61. The reason for the extraordinary pattern set forth above is that the purported grant dates set forth therein were not the actual dates on which the stock option grants were made. Rather, at the behest of the Option Recipient Defendants, the Compensation Committee, with the knowledge and approval of the other members of the Board, knowingly and deliberately backdated the stock option grants to make it appear as though the grants were made on dates when the market price of PI stock was lower than the market price on the actual grant dates. This improper backdating, which violated the terms of the Plan, resulted in option grants with lower exercise prices, which improperly increased the value of the options to the Option Recipient Defendants and improperly reduced the amounts the Option Recipient Defendants had to pay the Company upon exercise of the options.

**Dissemination of False Financial Statements**

62. The Audit Committee and Compensation Committee (at least during most years) contained the same members, so the Audit Committee members had actual knowledge of and/or were

1 reckless in not knowing of the backdating committed by the Compensation Committee, and thus had  
2 actual knowledge of and/or were reckless in not knowing that they were violating GAAP and  
3 disseminating false financial statements and false 10-Ks.

4 63. As a result of the improper backdating of stock options, the Company, with the  
5 knowledge, approval, and participation of each of the Individual Defendants:

- 6 a. violated the terms of the Plans by granting stock options with exercise  
7 prices less than the fair market value of the stock on the actual date of  
8 grant;
- 9 b. violated APB 25 by failing to recognize compensation expenses  
10 incurred when the improperly backdated options were granted;
- 11 c. violated Section 162(m) by taking tax deductions based on stock option  
12 grants that were not payable solely on account of the attainment of one  
13 or more performance goals and violated the terms of the Plans; and
- 14 d. produced and disseminated to PI shareholders and the market false  
15 financial statements that improperly recorded and accounted for the  
16 backdated option grants.

17 64. The Company, with the knowledge, approval, and participation of each of the Individual  
18 Defendants, disseminated its false financial statements in, *inter alia*, the following Form 10-K filings:

- 19 a. Form 10-K for fiscal year ended December 31, 1998, filed with the SEC  
20 on March 16, 1999 and signed by defendants Earhart, Staples, Kvamme  
21 and Sharp;
- 22 b. Form 10-K for fiscal year ended December 31, 1999, filed with the SEC  
23 on March 29, 2000 and signed by defendants Earhart, Staples, Kvamme,  
24 Sharp, Bickell, Brown, and Brathwaite;
- 25 c. Form 10-K for fiscal year ended December 31, 2000, filed with the SEC  
26 on March 20, 2001 and signed by defendants Earhart, Kvamme, Bickell,  
27 Sharp, Brown, Brathwaite and Lelieur;
- 28 d. Form 10-K for fiscal year ended December 31, 2001, filed with the SEC  
on March 22, 2002 and signed by defendants Earhart, Balakrishnan,  
Cobb, Kvamme, Sharp, Bickell, Brown, and Brathwaite;
- e. Form 10-K for fiscal year ended December 31, 2002, filed with the SEC  
on March 21, 2003 and signed by defendants Earhart, Balakrishnan,  
Cobb, Kvamme, Sharp, Bickell, Brown, and Brathwaite;
- f. Form 10-K for fiscal year ended December 31, 2003, filed with the SEC  
on March 10, 2004 and signed by defendants Earhart, Balakrishnan,  
Cobb, Kvamme, Sharp, Bickell, Brown, Brathwaite, and Iyer;

1 g. Form 10-K for fiscal year ended December 31, 2004, filed with the SEC  
2 on March 16, 2005 and signed by defendants Earhart, Balakrishnan,  
Cobb, Kvamme, Sharp, Bickell, Brown, Brathwaite, and Iyer.

3 65. Furthermore, in each of its Form 10-K Annual Reports filed with the SEC from 1995 to  
4 2001, the Company, with the knowledge, approval and participation of each of the Individual  
5 Defendants, falsely represented that it followed APB 25 to account for stock-based compensation:

6 The Company applies Accounting Principles Board Opinion No. 25 and  
7 related Interpretations in accounting for its stock option plans. No  
8 compensation cost has been recognized for the Company's stock option  
9 plans because the quoted market price of the Common Stock at the date  
of the grant was not in excess of the amount an employee must pay to  
acquire Common Stock.

10 66. Defendants Balakrishnan and Cobb filed false Certifications of Chief Executive Officer  
11 and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of  
12 the Sarbanes-Oxley Act of 2002 (the "Certifications"), certifying that each Annual Report of PI on  
13 Form 10-Ks "fully complies with the requirements of section 13(a) and 15(d) of the Securities  
14 Exchange Act of 1934; and the information contained in the Report fairly presents, in all material  
15 respects, the financial condition and results of operations of the Company." Defendants Balakrishnan  
16 and Cobb signed the following Certifications:

- 17 a. for the Form 10-K for the fiscal year ended December 31, 2002, filed  
with the SEC on March 21, 2003;
- 18 b. for the Form 10-K for the fiscal year ended December 31, 2003, filed  
19 with the SEC on March 10, 2004; and
- 20 c. for the Form 10-K for the fiscal year ended December 31, 2004, filed  
with the SEC on March 16, 2005.

21 **Concealment of Defendants' Misconduct**

22 67. From 1999 to 2005, the Company, with the knowledge, approval, and participation of  
23 each of the Individual Defendants, for the purpose and with the effect of concealing the improper option  
24 backdating alleged herein, disseminated to shareholders and filed with the SEC annual proxy statements  
25 that falsely reported the dates of stock option grants to the Option Recipient Defendants, as follows:

- 26 a. PI's proxy statement filed with the SEC on April 28, 1999 falsely  
27 reported that options granted to Earhart, Balakrishnan, Rumennick,  
Selleck, Staples and Walker were granted on July 2, 1998;

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- 1           b.     PI's proxy statement filed with the SEC on April 27, 2000 falsely  
2           reported that options granted to Earhart, Balakrishnan, Rumennick,  
3           Selleck and Walker were granted on April 20, 1999;
- 4           c.     PI's proxy statement filed with the SEC on April 27, 2001 falsely  
5           reported that options granted to Earhart, Balakrishnan, Rumennick,  
6           Selleck and Davies were granted on April 14, 2000;
- 7           d.     PI's proxy statement filed with the SEC on April 30, 2002 falsely  
8           reported that options granted to Earhart, Balakrishnan, Selleck and  
9           Walker were granted on May 31, 2001;
- 10          e.     PI's proxy statement filed with the SEC on April 30, 2003 falsely  
11          reported that options granted to Balakrishnan, Bell, Selleck, Tomlin  
12          and Walker were granted on February 21, 2002;
- 13          f.     PI's proxy statement filed with the SEC on April 26, 2004 falsely  
14          reported that options granted to Balakrishnan, Bell, Renouard,  
15          Selleck and Tomlin were granted on January 8, 2003; and
- 16          g.     PI's proxy statement filed with the SEC on April 27, 2005 falsely  
17          reported that options granted to Balakrishnan, Bell, Renouard,  
18          Tomlin and Walker were granted on February 2, 2004.

19           68.     From 2002 to 2006, PI, with the knowledge, approval, and participation of each of the  
20           Individual Defendants, for the purpose and with the effect of concealing the improper option  
21           backdating, filed with the SEC Form 4s that falsely reported the dates of stock option grants to the  
22           Option Recipient Defendants, as follows:

- 23           a.     Earhart's Form 4 filed with the SEC on January 10, 2002 falsely  
24           reported that options granted to Earhart were granted on July 2, 1998,  
25           April 20, 1999, April 14, 2000 and May 31, 2001;
- 26           b.     Bickell's Form 4 filed with the SEC on January 10, 2002 falsely  
27           reported that options granted to Bickell were granted on May 31,  
28           2001;
- c.     Brathwaite's Form 4 filed with the SEC on January 10, 2002 falsely  
          reported that options granted to Brathwaite were granted on January  
          31, 2000 and May 31, 2001;
- d.     Brown's Form 4 filed with the SEC on January 10, 2002 falsely  
          reported that options granted to Brown were granted on July 23, 1999  
          and May 31, 2001;
- e.     Sharp's Form 4 filed with the SEC on January 10, 2002 falsely  
          reported that options granted to Sharp were granted May 31, 2001;
- f.     Kvamme's Form 4 filed with the SEC on January 10, 2002 falsely  
          reported that options granted to Kvamme were granted on May 31,  
          2001;

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- g. Earhart's Form 4 filed with the SEC on February 11, 2002 falsely reported that options granted to Earhart were granted on July 2, 1998, April 20, 1999, April 14, 2000 and May 31, 2001;
- h. Earhart's Form 4s filed with the SEC on March 7, 2002 and June 10, 2002 falsely reported that options granted to Earhart were granted on July 2, 1998, April 20, 1999, April 14, 2000 and May 31, 2001;
- i. Bell's Form 4s filed with the SEC on March 7, 2002 and May 9, 2002 falsely reported that options granted to Bell were granted on May 31, 2001;
- j. Walkers's Form 4 filed with the SEC on June 10, 2002 falsely reported that options granted to Walker were granted on April 20, 1999, April 14, 2000, May 31, 2001 and February 21, 2002;
- k. Bell's Form 4 filed with the SEC on June 10, 2002 falsely reported that options granted to Bell were granted on May 31, 2001 and February 21, 2002;
- l. Selleck's Form 4 filed with the SEC on June 10, 2002 falsely reported that options granted to Selleck were granted on July 2, 1998 and February 21, 2002;
- m. Walker's Form 4 filed with the SEC on August 12, 2002 falsely reported that options granted to Walker were granted on April 20, 1999, April 14, 2000, May 31, 2001 and February 21, 2002;
- n. Balakrishnan's Form 4 filed with the SEC on August 12, 2002 falsely reported that options granted to Balakrishnan's were granted on April 20, 1999, April 14, 2000 and May 31, 2001;
- o. Selleck's Form 4 filed with the SEC on August 12, 2002 falsely reported that options granted to Selleck were granted on May 31, 2001 and February 21, 2002;
- p. Renouard's Form 4 filed with the SEC on August 12, 2002 falsely reported that options granted to Renouard were granted on February 21, 2002;
- q. Tomlin's Form 4 filed with the SEC on August 12, 2002 falsely reported that options granted to Tomlin were granted on February 21, 2002;
- r. Cobb's Form 4 filed with the SEC on August 12, 2002 falsely reported that options granted to Cobb were granted on May 31, 2001;
- s. Brathwaite's Form 4 filed with the SEC on November 18, 2002 falsely reported that options granted to Brathwaite were granted on May 31, 2001;

- 1 t. Bell and Earhart's Form 4s filed with the SEC November 22, 2002  
2 falsely reported that options granted to them were granted on May 31,  
2001;
- 3 u. Brathwaite's Form 4 filed with the SEC on January 19, 2003 falsely  
4 reported that options granted to Brathwaite were granted on May 31,  
2001;
- 5 v. Bell's Form 4 filed with the SEC on February 5, 2003 falsely  
6 reported that options granted to Bell were granted on May 31, 2001;
- 7 w. Morrish's Form 4s filed with the SEC on February 5, 2003 and  
8 February 18, 2003 falsely reported that options granted to Morrish  
9 were granted on August 5, 2002;
- 10 x. Bell and Earhart's Form 4s filed with the SEC February 26, 2003  
11 falsely reported that options granted to them were granted on May 31,  
12 2001;
- 13 y. Earhart's Form 4s filed with the SEC on February 27, 2003 and May  
14 5, 2003 falsely reported that options granted to Earhart were granted  
15 on May 31, 2001;
- 16 z. Morrish's Form 4 filed with the SEC on May 7, 2003 falsely reported  
17 that options granted to Morrish were granted on August 5, 2002;
- 18 aa. Bell's Form 4s filed with the SEC on May 7, 2003 and May 12, 2003  
19 falsely reported that options granted to Bell were granted on May 31,  
20 2001;
- 21 bb. Earhart's Form 4 filed with the SEC on May 13, 2003 falsely  
22 reported that options granted to Earhart were granted on May 31,  
23 2001;
- 24 cc. Bell's Form 4 filed with the SEC on May 27, 2003 falsely reported  
25 that options granted to Bell were granted on May 31, 2001;
- 26 dd. Renouard's Form 4 filed with the SEC on June 2, 2003 falsely  
27 reported that options granted to Renouard were granted on February  
28 21, 2002;
- ee. Bell's Form 4 filed with the SEC on July 29, 2003 falsely reported  
that options granted to Bell were granted on May 31, 2001;
- ff. Selleck's Form 4s filed with the SEC on July 31, 2003 and August 1,  
2003 falsely reported that options granted to Selleck were granted on  
July 2, 1998;
- gg. Earhart's Form 4 filed with the SEC on August 1, 2003 falsely  
reported that options granted to Earhart were granted on April 20,  
1999 and May 31, 2001;

- 1           hh.     Balakrishnan's Form 4 filed with the SEC on August 5, 2003 falsely  
2               reported that options granted to Balakrishnan were granted on April  
              20, 1999;
- 3           ii.     Morrish's Form 4 filed with the SEC on August 9, 2003 falsely  
4               reported that options granted to Morrish were granted on August 5,  
              2002;
- 5           jj.     Balakrishnan's Form 4 filed with the SEC on August 13, 2003 falsely  
6               reported that options granted to Balakrishnan were granted on April  
              20, 1999;
- 7           kk.     Earhart's Form 4 filed with the SEC on August 18, 2003 falsely  
8               reported that options granted to Earhart were granted on April 20,  
              1999;
- 9           ll.     Tomlin's Form 4s filed with the SEC on August 19, 2003 falsely  
10              reported that options granted to Tomlin were granted on February 21,  
              2002;
- 11          mm.     Balakrishnan's Form 4 filed with the SEC on August 19, 2003 falsely  
12              reported that options granted to Balakrishnan were granted on April  
              20, 1999;
- 13          nn.     Bell's Form 4 filed with the SEC on August 20, 2003 falsely reported  
14              that options granted to Bell were granted on May 31, 2001;
- 15          oo.     Selleck's Form 4 filed with the SEC on August 21, 2003 falsely  
16              reported that options granted to Selleck were granted on July 2, 1998;
- 17          pp.     Walker's Form 4 filed with the SEC on August 22, 2003 falsely  
18              reported that options granted to Walker were granted on April 20,  
19              1999;
- 20          qq.     Balakrishnan's Form 4 filed with the SEC on August 25, 2003 falsely  
21              reported that options granted to Balakrishnan were granted on April  
              20, 1999;
- 22          rr.     Brathwaite's Form 4 filed with the SEC on August 28, 2003 falsely  
23              reported that options granted to Brathwaite were granted on May 31,  
              2001;
- 24          ss.     Renouard's Form 4 filed with the SEC on September 2, 2003 falsely  
25              reported that options granted to Renouard were granted on February  
26              21, 2002;
- 27          tt.     Balakrishnan's Form 4s filed with the SEC on September 3, 2003,  
28              September 9, 2003, September 16, 2004, September 22, 2003,  
              September 29, 2003, October 7, 2003, October 21, 2003 and October  
              28, 2003 falsely reported that options granted to Balakrishnan were  
              granted on April 20, 1999;

- 1 uu. Selleck's Form 4 filed with the SEC on October 28, 2003 falsely  
2 reported that options granted to Selleck were granted on April 20,  
1999;
- 3 vv. Cobb's Form 4 filed with the SEC on October 28, 2003 falsely  
4 reported that options granted to Cobb were granted on May 31, 2001;
- 5 ww. Earhart's and Selleck's Form 4s filed with the SEC on October 29,  
6 2003 falsely reported that options granted to Earhart and Selleck were  
7 granted on April 20, 1999;
- 8 xx. Bell's Form 4 filed with the SEC on October 29, 2003 falsely  
9 reported that options granted to Bell were granted on May 31, 2001;
- 10 yy. Earhart's and Balakrishnan's Form 4s filed with the SEC on  
11 November 4, 2003 falsely reported that options granted to Earhart  
and Balakrishnan were granted on April 20, 1999;
- 12 zz. Morrish's Form 4 filed with the SEC on November 6, 2003 falsely  
13 reported that options granted to Morrish were granted on August 5,  
2002;
- 14 aaa. Balakrishnan's Form 4 filed with the SEC on November 11, 2003  
15 falsely reported that options granted to Balakrishnan were granted on  
April 20, 1999;
- 16 bbb. Selleck's Form 4 filed with the SEC on November 12, 2003 falsely  
17 reported that options granted to Selleck were granted on April 20,  
1999;
- 18 ccc. Balakrishnan's Form 4s filed with the SEC on November 18, 2003  
19 and November 24, 2004 falsely reported that options granted to  
Balakrishnan were granted on April 20, 1999;
- 20 ddd. Tomlin's Form 4 filed with the SEC on November 24, 2003 falsely  
21 reported that options granted to Tomlin were granted on January 8,  
2003 and February 21, 2002;
- 22 eee. Bell's Form 4 filed with the SEC on November 24, 2003 falsely  
23 reported that options granted to Bell were granted on May 31, 2001;
- 24 fff. Selleck's Form 4 filed with the SEC on November 26, 2003 falsely  
25 reported that options granted to Selleck were granted on April 14,  
2000 and April 20, 1999;
- 26 ggg. Walker's Form 4 filed with the SEC on November 26, 2003 falsely  
27 reported that options granted to Walker were granted on April 20,  
1999;
- 28 hhh. Renouard's Form 4s filed with the SEC on November 26, 2003 and  
December 1, 2003 falsely reported that options granted to Renouard  
were granted on February 21, 2002;

- 1           iii.     Balakrishnan's Form 4 filed with the SEC on December 1, 2003  
2                 falsely reported that options granted to Balakrishnan were granted on  
3                 April 20, 1999;
- 4           jjj.     Bell's Form 4 filed with the SEC on December 2, 2003 falsely  
5                 reported that options granted to Bell were granted on May 31, 2001;
- 6           kkk.     Balakrishnan's Form 4s filed with the SEC on December 9, 2003,  
7                 December 15, 2003, December 22, 2003 and December 30, 2003  
8                 falsely reported that options granted to Balakrishnan were granted on  
9                 April 20, 1999;
- 10          lll.     Balakrishnan's Form 4s filed with the SEC on January 6, 2004,  
11                 January 13, 2004, January 21, 2004 and January 26, 2004 falsely  
12                 reported that options granted to Balakrishnan were granted on April  
13                 20, 1999;
- 14          mmm.    Earhart's Form 4 filed with the SEC on January 26, 2004 falsely  
15                 reported that options granted to Earhart were granted on May 31,  
16                 2001;
- 17          nnn.     Balakrishnan's Form 4s filed with the SEC on February 3, 2004 and  
18                 February 6, 2004 falsely reported that options granted to  
19                 Balakrishnan were granted on April 20, 1999;
- 20          ooo.     Morrish's Form 4s filed with the SEC on February 9, 2004 falsely  
21                 reported that options granted to Morrish were granted on August 5,  
22                 2002;
- 23          ppp.     Selleck's Form 4s filed with the SEC on March 1, 2004 falsely  
24                 reported that options granted to Selleck were granted on April 14,  
25                 2000 and May 31, 2001;
- 26          qqq.     Selleck's Form 4 filed with the SEC on May 26, 2004 and May 27,  
27                 2004 falsely reported that options granted to Selleck were granted on  
28                 April 14, 2000
- rrr.     Morrish's Form 4 filed with the SEC on August 23, 2004 falsely  
                  reported that options granted to Morrish were granted on August 5,  
                  2002;
- sss.     Brathwaite's Form 4 filed with the SEC on August 31, 2004 falsely  
                  reported that options granted to Brathwaite were granted on May 31,  
                  2001;
- ttt.     Brathwaite's Form 4 filed with the SEC on May 18, 2005 falsely  
                  reported that options granted to Brathwaite were granted on May 31,  
                  2001;
- uuu.     Tomlin's Form 4 filed with the SEC on May 19, 2005 falsely  
                  reported that options granted to Tomlin were granted February 21,  
                  2002;

1 vvv. Cobb's Form 4 filed with the SEC on May 23, 2005 falsely reported  
2 that options granted to Cobb were granted on May 31, 2001;

3 www. Bell's Form 4 filed with the SEC on August 30, 2005 falsely reported  
4 that options granted to Bell were granted on May 31, 2001;

5 xxx. Balakrishnan's and Earhart's Form 4 filed with the SEC on February  
6 16, 2006 falsely reported that options granted to Balakrishnan and  
7 Earhart were granted on April 20, 1999;

8 yyy. Balakrishnan's Form 4 filed with the SEC on February 23, 2006 and  
9 March 1, 2006 falsely reported that options granted to Balakrishnan  
10 were granted on April 20, 1999;

11 **Backdating Revealed at PI**

12 69. The Individual Defendants continued to conceal their foregoing misconduct until March  
13 13, 2006, when PI issued a press release announcing an internal investigation of the Company's stock  
14 option granting practices.

15 70. On May 4, 2006, Earhart resigned as Chairman of the Board and Cobb resigned as the  
16 Chief Financial Officer of the Company.

17 71. On May 5, 2006, PI issued a press release announcing preliminary findings by the  
18 special committee indicated that options backdating had taken place, and as a result the Company would  
19 need to record additional stock based compensation and restate its financial statements for fiscal years  
20 1999 through 2005. Specifically, PI stated:

21 Power Integrations, Inc. (Nasdaq:POWI) disclosed on March 13, 2006 that it  
22 had created a special committee comprised of disinterested members of its  
23 board of directors to conduct an internal investigation of company practices  
24 related to stock option grants to officers and directors, and related matters.  
25 The special committee is being assisted by independent outside legal counsel  
26 and accounting experts. At this time, the special committee has not  
27 completed its work or reached final conclusions and is continuing its review.  
28 The special committee has reached a preliminary conclusion that **the actual  
dates of measurement for certain past stock option grants differed from  
the recorded grant dates for such awards. As a result, the company  
expects to record additional non-cash charges for stock-based  
compensation expenses in prior periods. Based on the special  
committee's preliminary conclusion, the company expects that such non-  
cash charges will be material and that the company may need to restate  
its historical financial statements for each of the fiscal years 1999  
through 2004, and for the first three quarters of the fiscal year ended  
December 31, 2005.** Such charges may also affect future periods. On May 4,  
2006, the audit committee of the company's board of directors concluded that  
such financial statements and any related reports of its independent registered  
public accounting firm should no longer be relied upon.

1 72. On May 11, 2006, PI filed with the SEC a Form 12b-25 which stated:

2 As previously announced, the Company's Board of Directors has formed a  
3 special committee to investigate the Company's practices related to stock  
4 option grants to officers and directors, and related matters. At this time, the  
5 special committee has not completed its work or reached final conclusions  
6 and is continuing its review. The special committee has reached a preliminary  
7 conclusion that the actual dates of measurement for certain past stock option  
8 grants differed from the recorded grant dates for such awards. As a result, the  
9 Company expects to record additional non-cash charges for stock-based  
10 compensation expenses in prior periods. Based on the special committee's  
11 preliminary conclusion, the Company expects that such non-cash charges will  
12 be material and that the Company may need to restate its historical financial  
13 statements for each of the fiscal years 1999 through 2004, and for the first  
14 three quarters of the fiscal year ended December 31, 2005. As a result, the  
15 Company is unable to file its quarterly report on Form 10-Q for the quarter  
16 ended March 31, 2006 by the prescribed filing date of May 10, 2006.

17 73. On May 24, 2006, PI filed with the SEC a Form 8-K announcing that the Company was  
18 under investigation by the SEC and the United States Department of Justice ("DOJ") in connection with  
19 its stock option granting practices.

20 74. On May 29, 2006, Citigroup issued a report titled "Stock Option Spotlight: Specialty  
21 Semiconductor Analysis," which identified through a statistical analysis certain companies in the  
22 semiconductor industry that analysts believed were at risk of being embroiled in the options backdating  
23 scandal. Citigroup's analysis, based on historical stock option granting data, found that PI was  
24 statistically the company most likely to have manipulated the stock option grants out of the seventeen  
25 semiconductor companies that the analysts sampled. Moreover, in an expanded cross technology sector  
26 analysis of thirty companies that had been flagged for potential stock option backdating, PI was again  
27 found to be most likely among them to have manipulated stock option grants.

28 75. On December 15, 2006, PI announced that it had been notified by NASDAQ that the  
Company's stock would be delisted from the exchange for failure to file timely quarterly and annual  
financial reports with the SEC.

76. On March 8, 2007, PI finally filed with the SEC a Form 10-K for the fiscal year ended  
December 31, 2005, announcing that the Company would be forced to recognize a \$30.5 million  
reduction in retained earnings as a result of improper stock option practices. Moreover, PI released the

1 conclusions of the Company's stock option investigation, which admitted that stock options had been  
2 backdated:

3 *Stock Compensation* - These adjustments are from our determination, based upon the  
4 Special Committee's investigation and our subsequent reviews and analyses, that the  
5 initially recorded measurement dates for various categories of option grants could not be  
6 relied upon. These categories included the following:

7 • New hire non-officer stock option grants accounted for as being made prior to the  
8 terms being fixed. Our practice was to set the exercise price of new hire non-officer  
9 awards based upon the fair value of our stock on the employee's hire date or the last day  
10 of the month of the employee's first month of employment, whichever was lower.  
11 Because this determination was made at the end of the month of hire, the last day of the  
12 month of the employee's first month of employment was determined to be the first date  
13 when the number of shares and the price of each grant were known with finality. Grants  
14 accounted for as being made before the last day of the month of the employee's first  
15 month of employment, which represented options to purchase an aggregate of 1,214,550  
16 shares, were accounted for as fixed awards under Accounting Principles Board Opinion  
17 (APB) No. 25 Accounting for Stock Issued to Employees, or APB 25.

18 • Stock option grants with insufficient or incomplete corporate approvals. We  
19 determined that for certain stock option grants the number of shares and the exercise  
20 price were not known with finality at the original measurement date. We determined  
21 that the original recorded grant date could not be relied on because there was  
22 correspondence or other evidence that indicated that not all required corporate approvals  
23 had been obtained, including the finalization of the number of stock options allocated  
24 and the related exercise price. We adopted a methodology to remeasure these option  
25 grants to a revised measurement date, as described below, and accounted for these  
26 grants, which represented options to purchase an aggregate of 6,358,639 shares, as fixed  
27 awards under APB 25.

28 • Stock option grants determined to have been cancelled and repriced. We determined  
that the terms of stock option grants to purchase an aggregate of 415,000 shares may  
have been communicated to employees and that those terms were subsequently  
modified. We concluded that such modifications constitute repricings and, therefore,  
these stock option grants should have been accounted for as variable awards for  
accounting purposes.

**The Director Defendants' Failure to Hold the Company's Required  
Annual Meeting of Shareholders**

77. Pursuant to Del. Gen. Corp. Law § 211(c), "[i]f there be a failure to hold the annual  
meeting or to take action by written consent to elect directors in lieu of an annual meeting for a period  
of 30 days after the date designated for the annual meeting, or if no date has been designated, for a  
period of 13 months after the latest to occur of the organization of the corporation, its last annual  
meeting or the last action by written consent to elect directors in lieu of an annual meeting, the Court of

1 Chancery may summarily order a meeting to be held upon the application of any stockholder or  
2 director.”

3 78. PI’s last annual shareholder meeting was held on June 3, 2005, exactly 26 months ago.

4 79. In violation of Delaware General Corporation Law § 211(c), the Director Defendants  
5 failed to schedule, provide notice of, or hold an annual meeting for 2006, and have yet to do so for  
6 2007.

7 **Individual Defendants’ Insider Selling**

8 80. From 1998 through 2006, certain of the Individual Defendants (collectively, the “Insider  
9 Selling Defendants”), while in possession of materially adverse non-public information regarding the  
10 backdating of stock options and the false financial statements resulting therefrom, sold over \$97 million  
11 of PI stock, a significant portion of which was obtained through the exercise of improperly backdated PI  
12 stock options, as follows:

<b>Defendant</b>	<b>Dates of Sales</b>	<b>Shares Sold</b>	<b>Proceeds</b>
Earhart	08/25/98 to 02/16/06	1,135,056	\$29,340,468.64
Balakrishnan	08/18/98 to 03/21/06	344,900	\$16,266,449.02
Bell	02/22/02 to 08/29/05	76,565	\$1,987,824.20
Bickell	11/09/00 to 07/26/01	1,000	\$17,660.00
Brathwaite	11/15/02 to 05/18/05	24,500	\$590,671.83
Brown	08/11/00	5,000	\$93,750.00
Cobb	11/25/02 to 05/23/05	96,664	\$2,672,506.76
Davies	02/08/00 to 02/25/00	15,000	\$728,250.00
Fassler	08/02/01 to 08/26/01	15,000	\$363,250.00
Kvamme	08/11/98 to 02/11/99	600,620	\$9,024,849.57
Lelieur	02/27/01	2,000	\$36,746.80
Morrish	02/05/03 to 11/04/04	60,625	\$1,582,568.86
Renouard	08/29/03 to 08/31/05	56,000	\$1,756,538.79
Roesler	05/02/01 to 08/27/01	2,395	\$49,853.75
Rumennick	10/26/98 to 04/30/01	94,774	\$4,394,485.50
Selleck	08/12/98 to 05/27/04	289,100	\$12,122,854.80
Sharp	11/12/98 to 05/28/03	43,234	\$1,024,103.98
Staples	10/26/98 to 11/04/99	139,500	\$6,888,545.00
Tomlin	08/12/03 to 05/19/05	74,550	\$2,296,956.29
Walker	10/26/98 to 11/25/03	238,835	\$6,349,864.01
<b>TOTAL</b>		<b>3,315,318</b>	<b>\$97,588,197.80</b>

27 81. Defendants Earhart, Balakrishnan, Bell, Bickell, Brathwaite, Brown, Cobb, Davies,  
28

1 Fassler, Kvamme, Lelieur, Morrish, Renouard, Roesler, Rumennick, Selleck, Sharp, Staples, Tomlin  
2 and Walker, are hereinafter referred to at the “Insider Selling Defendants.”

3 **PI’S FALSE FINANCIAL REPORTING IN VIOLATION OF**  
4 **GAAP, SEC REGULATIONS AND IRS RULES AND REGULATIONS**

5 82. As a result of the Individual Defendants’ improper backdating of stock options, the  
6 Individual Defendants caused PI to violate GAAP, SEC regulations and IRS rules and regulations.

7 83. PI’s financial results for 1994 through 2006 were included in reports filed with the SEC  
8 and in other shareholder reports. In these reports, the Individual Defendants represented that PI’s  
9 financial results were presented in a fair manner and in accordance with GAAP.

10 84. The Individual Defendants’ representations were false and misleading as to the financial  
11 information reported, as such financial information was not prepared in conformity with GAAP, nor  
12 was the financial information “a fair presentation” of the Company’s financial condition and operations,  
13 causing the financial results to be presented in violation of GAAP and SEC rules.

14 85. GAAP consists of those principles recognized by the accounting profession as the  
15 conventions, rules, and procedures necessary to define accepted accounting practice at the particular  
16 time. Regulation S-X, to which the Company is subject as a registrant under the Exchange Act, 17  
17 C.F.R. §210.4-01(a)(1), provides that financial statements filed with the SEC, which are not prepared in  
18 compliance with GAAP, are presumed to be misleading and inaccurate.

19 **Violations of GAAP**

20 86. During the relevant period, the Individual Defendants caused the Company to understate  
21 its compensation expenses by not properly accounting for its stock options under GAAP and thus  
22 overstated the Company’s net earnings.

23 87. Under well-settled accounting principles in effect throughout the relevant period, PI did  
24 not need to record an expense for options granted to employees at the current market price (“at the  
25 money”). The Company was, however, required to record an expense in its financial statements for any  
26 options granted below the current market price (“in the money”). In order to provide PI executives and  
27 employees with far more lucrative “in the money” options, while avoiding having to inform  
28 shareholders about millions of dollars incurred by the Company in compensation expenses (and without

1 paying the IRS millions of dollars in employment taxes), the Individual Defendants systematically  
2 falsified Company records to create the false appearance that options had been granted at the market  
3 price on an earlier date.

4 88. Throughout the relevant period, PI accounted for stock options using the intrinsic  
5 method described in APB No. 25, "Accounting for Stock Issued to Employees." Under APB No. 25,  
6 employers were required to record as an expense on their financial statements the "intrinsic value" of a  
7 fixed stock option on its "measurement date." An option that is in-the-money on the measurement date  
8 has intrinsic value, and the difference between its exercise price and the quoted market price must be  
9 recorded as compensation expense to be recognized over the vesting period of the option. Options that  
10 are at-the-money or out-of-the-money on the measurement date need not be expensed. Excluding non-  
11 employee directors, APB No. 25 required employers to record compensation expenses on options  
12 granted to non-employees irrespective of whether they were in-the-money or not on the date of grant.

13 **PI's GAAP Violations Were Material**

14 89. PI's false and misleading relevant period statements and omissions regarding its  
15 accounting were material, particularly in light of SEC guidance on materiality. SEC Staff Accounting  
16 Bulletin ("SAB") Topic 1M, Materiality, summarizes GAAP definitions of materiality. Among other  
17 items, SAB Topic 1M says: "A matter is 'material' if there is a substantial likelihood that a reasonable  
18 person would consider it important." It also stresses that materiality requires qualitative, as well as  
19 quantitative, considerations. For example, if a known misstatement would cause a significant market  
20 reaction that reaction should be taken into account in determining the materiality of the misstatement.

21 90. SAB Topic 1M further states:

22 Among the considerations that may well render material a quantitatively  
23 small misstatement of a financial statement item are –

24 \* \* \*

25 whether the misstatement masks a change in earnings or other trends

26 whether the misstatement hides a failure to meet analysts' consensus  
27 expectations for the enterprise

28 \* \* \*

whether the misstatement concerns a segment or other portion of the  
registrant's business that has been identified as playing a significant role in the

1 registrant's operations or profitability.

2 91. SAB Topic 1M also says that an intentional misstatement of even immaterial items may  
3 be illegal and constitute fraudulent financial reporting.

4 92. PI's misstatements satisfy these criteria and thus were material from both a quantitative  
5 and qualitative perspective.

6 **PI's Financial Statements Violated Fundamental Concepts of GAAP**

7 93. Due to these accounting improprieties, the Company presented its financial results and  
8 statements in a manner that violated GAAP, which are described by the following statements:

- 9 (a) The principle that interim financial reporting should be based upon the  
10 same accounting principles and practices used to prepare annual  
11 financial statements (APB No. 28, ¶10);
- 12 (b) The principle that financial reporting should provide information that is  
13 useful to existing and potential investors and creditors and other users in  
14 making rational investment, credit and similar decisions (FASB  
15 Statement of Concepts No. 1, ¶34);
- 16 (c) The principle that financial reporting should provide information about  
17 the economic resources of an enterprise, the claims to those resources,  
18 and the effects of transactions, events and circumstances that change  
19 resources and claims to those resources (Financial Accounting  
20 Standards Board ("FASB") Statement of Concepts No. 1, ¶40);
- 21 (d) The principle that financial reporting should provide information about  
22 how management of an enterprise has discharged its stewardship  
23 responsibility to stockholders for the use of enterprise resources  
24 entrusted to it. To the extent that management offers securities of the  
25 enterprise to the public, it voluntarily accepts wider responsibilities for  
26 accountability to prospective investors and to the public in general  
27 (FASB Statement of Concepts No. 1, ¶50);
- 28 (e) The principle that financial reporting should be reliable in that it  
represents what it purports to represent (FASB Statement of Concepts  
No. 2, ¶¶58-59);
- (f) The principle of completeness, which means that nothing is left out of  
the information that may be necessary to insure that it validly represents  
underlying events and conditions (FASB Statement of Concepts No. 2,  
¶79); and
- (g) The principle that conservatism be used as a prudent reaction to  
uncertainty to try to ensure that uncertainties and risks inherent in  
business situations are adequately considered (FASB Statement of  
Concepts No. 2, ¶¶95, 97).

1 94. Further, the undisclosed adverse information concealed by the Individual Defendants  
2 during the relevant period is the type of information which, because of SEC regulations, regulations of  
3 the national stock exchanges and customary business practice, is expected by investors and securities  
4 analysts to be disclosed and is known by corporate officials and their legal and financial advisors to be  
5 the type of information which is expected to be and must be disclosed.

6 **PI's Financial Statements Violated SEC Regulations**

7 95. During the relevant period, the Individual Defendants caused PI to violate SEC  
8 regulations by failing to disclose that the Company's senior executives had been granted backdated  
9 stock options.

10 96. Under SEC Regulations, Item 8 of Form 14-A and Item 11 of Form 10-K, an issuer must  
11 furnish information required by Item 402 of Regulation S-K [17 C.F.R. §229.303]. Item 402(b) and (c)  
12 require a company to provide both a Summary Compensation Table and an Option/SAR Grants table  
13 identifying the compensation of the named executive officers – the Company's CEO and its next four  
14 most highly paid executives. Item 402 requires particularized disclosures involving a company's stock  
15 option grants in the last fiscal year. In the summary compensation table, the issuer must identify in a  
16 column "other annual compensation" received by the named executives that is not properly categorized  
17 as salary or bonus, including any "[a]bove market or preferential earnings on restricted stock, options,  
18 SARs or deferred compensation" paid to the officer during the period. Item 402(b)(2)(iii)(C)(2). In the  
19 option grant table, the issuer must identify in a column "[t]he per-share exercise or base price of the  
20 options. . . . If such exercise or base price is less than the market price of the underlying security on the  
21 date of grant, a separate, adjoining column shall be added showing market price on the date of grant. . .  
22 ." Item 402(c)(2)(iv).

23 97. The Individual Defendants caused PI to violate SEC regulations by failing to disclose  
24 that the Company's named executive officers had been granted options with exercise prices below the  
25 market value on the date that the Compensation Committee approved the grant.

26 **PI's Violations of IRS Rules and Regulations**

27 98. During the relevant period, the Individual Defendants further caused PI to violate IRS  
28

1 rules and regulations due to its improper accounting for the backdated stock options. As a result, the  
2 Company's tax liabilities were understated, exposing PI to potential amounts owed for back taxes,  
3 penalties and interest to the IRS for improperly reporting compensation.

4 99. The Individual Defendants caused the Company to violate IRS Code §162(m), which  
5 generally limits a publicly traded company's tax deductions for compensation paid to each of its named  
6 executive officers to \$1 million unless the pay is determined to be "performance-based." In order for  
7 compensation to be performance-based, the Compensation Committee must have set pre-established  
8 and objective performance goals. The goals must then be approved by the shareholders. Section 162(m)  
9 defines stock options as performance-based provided they are issued at an exercise price that is no less  
10 than the fair market value of the stock on the date of the grant. Accordingly, properly issued stock  
11 options do not have to be taken into account in calculating whether an executive's compensation has  
12 exceeded the \$1 million compensation cap.

13 100. Section 162(m), known as the \$1 million rule, was enacted in 1993 in order to tie top  
14 executives' soaring pay packages more closely to a company's performance. This change in the tax law  
15 turned compensation practices for a company's top executives away from straight salary-based  
16 compensation to performance-based compensation, including stock options. According to former SEC  
17 Chairman Harvey Pitt: "What [162[m]] did was create incentives to find other forms of compensation  
18 so people could get over the \$1 million threshold without running afoul of the code."

19 101. The Individual Defendants caused PI to violate IRS Code §162(m) by providing  
20 backdated options to the Company's named executive officers, which were granted with exercise prices  
21 that were less than the fair market value of the stock on the date of the grant. As a result all of the  
22 income resulting from the exercise of the options must be included for purposes of calculating whether  
23 the named executive's compensation exceeds the \$1 million cap for federal tax purposes.

24 102. The Individual Defendants further caused the Company to violate IRS rules and  
25 regulations in order to avoid having to withhold income and FICA tax from its executives and  
26 employees upon the exercise of PI's stock options by improperly accounting for its Nonqualified Stock  
27 Options ("NSOs") as Incentive Stock Options ("ISOs").

28

1 103. ISOs are a form of equity compensation that may be provided to a company's  
 2 employees. ISOs are required to be granted at an exercise price that is no less than the fair market value  
 3 of the stock on the date of the grant and are entitled to preferential tax treatment as they are not subject  
 4 to income tax upon exercise of the options but only upon sale of the stock (except for the possible  
 5 imposition of alternative minimum tax on the option spread at the time of exercise). Stock options that  
 6 do not qualify as ISOs are considered to be NSOs. NSOs are not entitled to preferential treatment as  
 7 they are subject to income tax and FICA withholding upon exercise. As a result, a company that fails to  
 8 withhold income tax and/or FICA upon the exercise of NSOs by its employees would be liable for the  
 9 amount of the income tax and FICA that the company failed to withhold upon exercise of the options, in  
 10 addition to interest and penalties.

11 104. By improperly treating its backdated options as ISOs, the Individual Defendants failed to  
 12 provide proper income tax and FICA withholdings upon the exercise of its options by its executives and  
 13 employees in violation of IRS rules and regulations.

14 105. The chart below illustrates PI's false and misleading fiscal year financial results which  
 15 materially understated its compensation expenses and thus overstated its earnings:

<b>Fiscal Year Ended</b>	<b>Reported Net Income (Loss) In Thousands</b>	<b>Reported Diluted Earnings (Loss) Per Share</b>
December 31, 1997	\$4,762	\$0.25
December 31, 1998	\$12,678	\$0.48
December 31, 1999	\$24,477	\$0.87
December 31, 2000	\$19,765	\$0.69
December 31, 2001	\$6,726	\$0.23
December 31, 2002	\$9,578	\$0.32
December 31, 2003	\$18,085	\$0.57
December 31, 2004	\$20,367	\$0.63

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 19  
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 23  
 24  
 25 106. Meanwhile, the Individual Defendants were causing the Company to grant them  
 26 hundreds of thousands of backdated PI stock options. The Company's executives received a significant  
 27 number of backdated PI stock options as compensation during the relevant period.  
 28

1                   **THE INDIVIDUAL DEFENDANTS’ BREACHES OF FIDUCIARY DUTIES**  
2                   **AND THE DAMAGES THEY CAUSED THE COMPANY TO SUSTAIN**

3                   107. Former Securities and Exchange Commission (“SEC”) Chairman Harvey L. Pitt was  
4 recently quoted as stating, “What’s so terrible about backdating options grants? For one thing, it likely  
5 renders a company’s proxy materials false and misleading. Proxies typically indicate that options are  
6 granted at fair market value. But if the grant is backdated, the options value isn’t fair – at least not from  
7 the vantage point of the company and its shareholders.”

8                   108. Moreover, SEC Chairman Christopher Cox recently announced that “[backdating in  
9 many cases] makes a hash of (companies’) financial statements . . . [and is] poisonous [to efficient  
10 markets]. . . . It is securities fraud if you falsify books and records. It is securities fraud if you present  
11 financial statements to the SEC that do not comply with generally accepted accounting principles.  
12 There is no requirement that (the defendant) personally profit [to prove that a crime occurred.]”

13                   109. Referring to options backdating, Senator Chuck Grassley stated: “It is behavior that, to  
14 put it bluntly, is disgusting and repulsive. It is behavior that ignores the concept of an ‘honest day’s  
15 work for an honest day’s pay’ and replaces it with a phrase that we hear all too often today, ‘I’m going  
16 to get mine.’ . . . [S]hareholders and rank-and-file employees were ripped off by senior executives who  
17 rigged stock option programs – through a process called ‘back-dating’ – to further enrich themselves.  
18 And as we have found far too often in corporate scandals of recent years, boards of directors were either  
19 asleep at the switch, or in some cases, willing accomplices themselves. . . .”

20                   110. Deputy Attorney General Paul J. McNulty has described the practice of stock option  
21 backdating “as a brazen abuse of corporate power to artificially inflate the salaries of corporate  
22 wrongdoers at the expense of shareholders.”

23                   111. In addition to the foregoing, a recent academic study revealed that outside directors of  
24 companies were also benefiting from backdating and were recipients of manipulated stock option  
25 grants, as detailed in the following *Wall Street Journal* article published on December 18, 2006:  
26  
27  
28

1 A new academic study suggests that many outside directors received  
2 manipulated stock-option grants, a finding that may help explain why the  
practice of options backdating wasn't stopped by the boards of some companies.

3 The statistical study, which names no individuals or firms, estimates that 1,400  
4 outside directors at 460 companies received questionable option grants,  
suggesting the widespread practice extended well beyond the executive suite.

5 The study is notable because it suggests that outside, or independent, directors --  
6 who are supposed to play a special role safeguarding against cozy board  
relationships with management -- may have been co-opted in options backdating  
7 by receiving manipulated grants themselves. The New York Stock Exchange  
requires that a majority of board seats, and all compensation- and audit-  
8 committee members, be independent . . . .

9 The evidence "contributes to understanding the possible factors that led to or  
10 enabled manipulation to occur," states the unpublished study, which was  
conducted by professors at Harvard and Cornell universities and the French  
business school Insead . . . .

11 The new study examined nearly 29,000 option grants awarded to outside  
12 directors at 6,577 firms between 1996 and 2005. It found that 9% of the grants  
fell on days when the stock price was equal to a monthly low. A random  
13 selection would lead to about 5% of grants being awarded at monthly lows. In  
addition, 3.8% of the grants were awarded when the share price was at the  
14 lowest price of the calendar quarter, also higher than would be expected based  
on random selection . . . .

15 112. In a misguided effort to attract and retain employees in a competitive environment, the  
16 Individual Defendants exceeded the bounds of the law and legitimate business judgment by perpetrating  
17 their backdating scheme. The Individual Defendants' misconduct was unjustifiable and constituted a  
18 gross breach of their fiduciary duties as officers and/or directors of the Company. Specifically, the  
19 Individual Defendants breached their fiduciary duties by:

- 20 a. colluding with each other to backdate stock option grants;
- 21 b. colluding with each other to violate GAAP and Section 162(m);
- 22 c. colluding with each other to produce and disseminate to PI shareholders  
23 and the market false financial statements that improperly recorded and  
accounted for the backdated option grants and concealed the improper  
24 backdating of stock options; and
- 25 d. colluding with each other to file false financial statements, false proxy  
statements and false Form 4s in order to conceal the improper  
26 backdating of stock options.

27  
28

1 113. The Individual Defendants' foregoing misconduct was not, and could not have been, an  
2 exercise of good faith business judgment. Rather, it was intended to, and did, unduly benefit the Option  
3 Recipient Defendants at the expense of the Company.

4 114. As a direct and proximate result of the Individual Defendants' foregoing breaches of  
5 fiduciary duties, the Company has sustained millions of dollars in damages, including, but not limited  
6 to, the additional compensation expenses and tax liabilities the Company has been required to incur,  
7 loss of funds paid to the Company upon exercise of options resulting from the difference between the  
8 fair market value of the stock option on the true date of grant and the price that was actually paid as a  
9 result of the backdated stock option grant, and costs and expenses incurred in connection with the  
10 Company's restatement of historical financial statements, internal investigation, and SEC and DOJ  
11 investigations of the Company.

12 115. The Option Recipient Defendants have exercised hundreds of thousands of backdated  
13 options at improperly low prices and have then sold the shares for substantial profits. Consequently, the  
14 Option Recipient Defendants have been unjustly enriched by garnering millions of dollars in illicit  
15 profits and depriving the Company of millions of dollars in payments that the Company should have  
16 received upon exercise of the options.

17 **DERIVATIVE AND DEMAND EXCUSED ALLEGATIONS**

18 116. Plaintiffs bring this action derivatively in the right and for the benefit of the Company to  
19 redress defendants' breaches of fiduciary duties and unjust enrichment.

20 117. Plaintiffs are owners of PI common stock and were owners of PI common stock at all  
21 times relevant hereto.

22 118. Plaintiffs will adequately and fairly represent the interests of the Company and its  
23 shareholders in enforcing and prosecuting its rights.

24 119. As a result of the facts set forth herein, plaintiffs have not made any demand on the PI  
25 Board of Directors to institute this action against the Individual Defendants. Such demand would be a  
26 futile and useless act because the Board is incapable of making an independent and disinterested  
27 decision to institute and vigorously prosecute this action.

28

1           120. At the time this action was commenced the Board consisted of nine directors: defendants  
2 Earhart, Balakrishnan, Kvamme, Bickell, Brown, Brathwaite, Iyer, and Sharp, and Fiebiger. The  
3 following directors are incapable of independently and disinterestedly considering a demand to  
4 commence and vigorously prosecute this action:

- 5           a. Earhart, Balakrishnan, Kvamme, Bickell, Brown, Brathwaite, Iyer,  
6 Sharp and Fiebiger because all the Director Defendants violated  
7 Delaware law by failing to schedule, provide notice of, or hold an  
8 annual meeting for 2006. The Director Defendants' violation of  
9 Delaware General Corporation Law § 211(c) was not the result of  
10 good faith business judgment, but rather was the result of the Director  
11 Defendants' failure to exercise good faith business judgment and/or  
12 their failure to inform themselves to a degree reasonably necessary  
13 under the circumstances;
- 14           b. Earhart, Balakrishnan, Kvamme, Bickell, Brown, Brathwaite, and  
15 Sharp because they are directly interested in the improperly  
16 backdated stock option grants they received and, with respect to the  
17 members of the Compensation Committee, granted themselves;
- 18           c. Kvamme, Bickell, and Brown because as members of the  
19 Compensation Committee they knowingly and deliberately backdated  
20 grants of stock options to themselves and others, as alleged herein,  
21 and are substantially likely to be held liable for breaching their  
22 fiduciary duties. Moreover, by colluding with the Option Recipient  
23 Defendants and others, as alleged herein, they have demonstrated that  
24 they are unable or unwilling to act independently of the Option  
25 Recipient Defendants;
- 26           d. Kvamme, Bickell, Brathwaite, and Iyer because as members of the  
27 Audit Committee they knowingly and deliberately participated in and  
28 approved the Company's violations of GAAP and Section 162(m), as  
alleged herein, and are substantially likely to be held liable for  
breaching their fiduciary duties. Moreover, by colluding with the  
Option Recipient Defendants and others, as alleged herein, they have  
demonstrated that they are unable or unwilling to act independently  
of the Option Recipient Defendants; and
- e. Balakrishnan, because his principal professional occupation is his  
employment as President and Chief Executive Officer ("CEO") of the  
Company. As President and CEO of the Company, Balakrishnan  
stands to earn hundreds of thousands of dollars in annual salary,  
bonuses, and other compensation, all of which must be approved by  
defendants Kvamme, Bickell and Brown, who are current members  
of the Compensation Committee. Accordingly, Balakrishnan is  
incapable of independently and disinterestedly considering a demand  
to commence and vigorously prosecute this action against the  
Individual Defendants.

1 121. Furthermore, demand is excused because the misconduct complained of herein was not,  
 2 and could not have been, an exercise of good faith business judgment. As represented in PI's proxy  
 3 statements, the stated purposes of the Plans are to attract, retain and reward executives by "to align  
 4 executive officer compensation with Power Integrations' performance." However, by granting PI stock  
 5 options with backdated exercise prices, the Individual Defendants undermined the purpose of the stock  
 6 option plans by awarding employees compensation that had intrinsic value regardless of PI's  
 7 performance. In effect, this practice was nothing more than secret handouts to executives and  
 8 employees at the expense of unsuspecting shareholders and the Company.

9 122. The Individual Defendants could have achieved the stated purpose of attracting,  
 10 retaining and reward executives by granting those employees additional stock options under their  
 11 incentive plans, or by granting stock options at a price less than the fair market value on the date of the  
 12 grant and simply disclosing and expensing these grants. Instead, the Individual Defendants backdated  
 13 stock option grants in violation of the Company's shareholder-approved stock option plans and  
 14 improperly reported these grants in their financial disclosures to improve their bottom line.

15 123. The practice of backdating stock options cannot be a valid exercise of business judgment  
 16 because it has subjected PI to potentially massive liability. The SEC and DOJ have initiated  
 17 investigations into PI's stock option granting practices. PI will also likely suffer tax liabilities for the  
 18 additional compensation it will have to expense, and it has tarnished its reputation in the investment  
 19 community through this deliberate and calculated conduct.

20 124. The following chart summarizes the positions of the Director Defendants:

<b>Defendant</b>	<b>Recipient of Back-Dated Option Grant(s)</b>	<b>Member of Compensation Committee during relevant period</b>	<b>Member of Audit Committee during relevant period</b>
<b>Earhart</b>	<b>x</b>		
<b>Sharp</b>	<b>x</b>		
<b>Balakrishnan</b>	<b>x</b>		
<b>Kvamme</b>	<b>x</b>	<b>x</b>	<b>x</b>
<b>Bickell</b>	<b>x</b>	<b>x</b>	<b>x</b>
<b>Brown</b>	<b>x</b>	<b>x</b>	
<b>Brathwaite</b>	<b>x</b>		<b>x</b>
<b>Iyer</b>			<b>x</b>

**COUNT I**

**Against the Individual Defendants for**

**Violations of §10(b) and Rule 10b-5 of the Securities and Exchange Act**

1  
2  
3  
4 125. Plaintiffs incorporate by reference and reallege each and every allegation set forth above,  
5 as though fully set forth herein.

6 126. Throughout the relevant period, the Individual Defendants individually and in concert,  
7 directly and indirectly, by the use and means of instrumentalities of interstate commerce and/or of the  
8 mails, intentionally or recklessly employed devices, schemes and artifices to defraud and engaged in  
9 acts, practices and a course of business which operated as a fraud and deceit upon the Company.

10 127. The Individual Defendants, as top executive officers and/or directors of the Company,  
11 are liable as direct participants in the wrongs complained of herein. Through their positions of control  
12 and authority as officers and/or directors of the Company, each of the Individual Defendants was able to  
13 and did control the conduct complained of herein.

14 128. The Individual Defendants acted with scienter in that they either had actual knowledge  
15 of the fraud set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain  
16 and to disclose the true facts, even though such facts were available to them. The Individual  
17 Defendants were among the senior management and/or directors of the Company and were therefore  
18 directly responsible for the fraud alleged herein.

19 129. The Company relied upon the Individual Defendants' fraud in granting the Individual  
20 Defendants options to purchase shares of the Company's common stock, as alleged herein.

21 130. As a direct and proximate result of the Individual Defendants' fraud, the Company has  
22 sustained millions of dollars in damages, including, but not limited to, the additional compensation  
23 expenses and tax liabilities the Company has been required to incur, loss of funds paid to the Company  
24 upon exercise of options resulting from the difference between the fair market value of the stock option  
25 on the true date of grant and the price that was actually paid as a result of the backdated stock option  
26 grant, and costs and expenses incurred in connection with the Company's restatement of historical  
27 financial statements, internal investigation, and SEC and DOJ investigations of the Company.

**COUNT II**

**Against the Individual Defendants for**

**Violations of §14(a) of the Securities Exchange Act**

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

6 132. Rule 14-A-9, promulgated pursuant to §14(a) of the Exchange Act, provides that no  
7 proxy statement shall contain “any statement which, at the time and in the light of the circumstances  
8 under which it is made, is false or misleading with respect to any material fact, or which omits to state  
9 any material fact necessary in order to make the statements therein not false or misleading.” 17 C.F.R.  
10 §240.14-A-9.

11 133. The proxy statements described herein violated §14(a) and Rule 14-A-9 because they  
12 omitted material facts, including the fact that the Individual Defendants were causing PI to engage in an  
13 option backdating scheme, a fact which the Individual Defendants were aware of and participated  
14 starting in 1995.

15 134. In the exercise of reasonable care, the Individual Defendants should have known that the  
16 proxy statements were materially false and misleading.

17 135. The misrepresentations and omissions in the proxy statements were material. The proxy  
18 statements were an essential link in the accomplishment of the continuation of the Individual  
19 Defendants’ unlawful stock option backdating scheme, as revelations of the truth would have  
20 immediately thwarted a continuation of the shareholders’ endorsement of the directors’ positions, the  
21 executive officers’ compensation and the Company’s compensation policies.

22 136. The Company was damaged as a result of the material misrepresentations and omissions  
23 in the Proxy Statements.

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1 **COUNT III**

2 **Against Earhart, Balakrishnan, Lelieur, Cobb and the Director Defendants for**

3 **Violations of §20(a) of the Securities Exchange Act**

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

6 138. Earhart, Balakrishnan, Lelieur, Cobb and the Director Defendants, by virtue of their  
7 positions with PI and their specific acts, were, at the time of the wrongs alleged herein, controlling  
8 persons of PI within the meaning of §20(a) of the Exchange Act. They had the power and influence and  
9 exercised the same to cause PI to engage in the illegal conduct and practices complained of herein.

10 **COUNT IV**

11 **Against the Individual Defendants for**

12 **Accounting**

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

15 116. As alleged in detail herein, each of the Individual Defendants had a fiduciary duty to,  
16 among other things, refrain from unduly benefiting themselves and other Company insiders at the  
17 expense of the Company.

18 117. As alleged in detail herein, the Individual Defendants breached their fiduciary duties by,  
19 among other things, engaging in a scheme to grant backdated stock options to themselves and/or certain  
20 other officers, directors, and other employees of the Company and cover up their misconduct.

21 118. The Individual Defendants possess complete and unfettered control over the improperly  
22 issued stock option grants and the books and records of the Company concerning the details of such  
23 improperly backdated stock option grants.

24 119. As a result of the Individual Defendants' misconduct, PI has been damaged financially  
25 and is entitled to a recovery as a result thereof.

26 120. Plaintiffs demand an accounting be made of all stock option grants made to the Option  
27 Recipient Defendants, including, but not limited to, the dates of the grants, the amounts of the grants,  
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1 the value of the grants, the recipients of the grants, the dates the options were exercised, as well as the  
2 disposition of any proceeds received by any of the Individual Defendants via sale or other exercise of  
3 the grants.

4 **COUNT V**

5 **Against the Individual Defendants for**

6 **Breach of Fiduciary Duty and/or Aiding and Abetting**

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

9 122. As alleged in detail herein, each of the Individual Defendants had a fiduciary duty to,  
10 among other things, refrain from unduly benefiting themselves and other Company insiders at the  
11 expense of the Company.

12 123. As alleged in detail herein, the Individual Defendants breached their fiduciary duties by,  
13 among other things, engaging in a scheme to grant backdated stock options to themselves and/or certain  
14 other officers, directors, and other employees of the Company and cover up their misconduct.

15 124. In breach of their fiduciary duties of loyalty and good faith, the Individual Defendants  
16 agreed to and did participate with and/or aided and abetted one another in a deliberate course of action  
17 designed to divert corporate assets to themselves and/or other Company insiders.

18 125. The Individual Defendants' foregoing misconduct was not, and could not have been, an  
19 exercise of good faith business judgment. Rather, it was intended to, and did, unduly benefit the Option  
20 Recipient Defendants at the expense of the Company.

21 126. As a direct and proximate result of the Individual Defendants' breaches of fiduciary  
22 duties, the Company has sustained damages, including, but not limited to, the additional compensation  
23 expenses and tax liabilities the Company has been required to incur, loss of funds paid to the Company  
24 upon exercise of options resulting from the difference between the fair market value of the stock option  
25 on the true date of grant and the price that was actually paid as a result of the backdated stock option  
26 grant, and costs and expenses incurred in connection with the Company's restatement of historical  
27 financial statements, internal investigation, and SEC and DOJ investigations of the Company.

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**COUNT VI**

**Against the Option Recipient Defendants for  
Common Law Restitution/Unjust Enrichment**

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

128. The Option Recipient Defendants were unjustly enriched by their receipt and retention of backdated stock option grants and the proceeds they received through exercising backdated stock options, as alleged herein, and it would be unconscionable to allow them to retain the benefits thereof.

129. To remedy the Option Recipient Defendants' unjust enrichment, the Court should order them to disgorge to the Company all of the backdated stock options they received, including the proceeds of any such options that have been exercised, sold, pledged, or otherwise monetized.

**COUNT VII**

**Against the Option Recipient Defendants for  
Rescission**

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

131. As alleged herein, the stock option contracts between the Option Recipient Defendants and the Company entered into during the relevant period were obtained through the Individual Defendants' breaches of fiduciary duties. Further, the backdated stock options were illegal grants and thus invalid as they were not authorized in accordance with the terms of the Company's shareholder-approved stock option plans.

132. All contracts which provide for stock option grants to the Option Recipient Defendants and were entered into during the relevant period should, therefore, be rescinded, with all sums paid under such contracts returned to the Company, and all such executory contracts cancelled and declared void.

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**COUNT VIII**

**Against the Director Defendants for**

**Violation of Delaware Law**

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

134. Pursuant to Delaware law, PI is required to hold an annual meeting of shareholders at least once every 13 months.

135. PI's last annual meeting was held on May 16, 2006, more than 13 months ago.

136. In violation of Delaware law, the Director Defendants failed to schedule, provide notice of, or hold an annual meeting for 2006 or 2007.

137. To remedy the Director Defendants' foregoing violation of Delaware law, the Court should issue an Order requiring the Director Defendants within ten (10) days to: (i) schedule an annual meeting of PI's shareholders to be held no later than thirty (30) days from the date of the Order; and (ii) provide to PI's shareholders notice of the annual meeting in accordance with PI's by-laws.

**COUNT IX**

**Against the Insider Selling Defendants for**

**Insider Selling and Misappropriation of Information**

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

139. At the time of each of the sales of PI stock described herein, the Insider Selling Defendants were in possession of material non-public information concerning the Company's stock option backdating practices and their effects on PI's reported financial results, e.g., that PI's net income was overstated, as set forth herein.

140. Each of the Insider Selling Defendants made each of their stock sales on the basis of and because of the material non-public information described herein.



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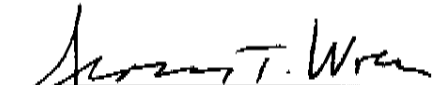
*Additional Counsel for Plaintiff DeBoskey*

**VERIFICATION**

I, Geoffrey Wren, hereby verify that I have authorized the filing of the attached Plaintiff's Amended Consolidated Shareholder Derivative Complaint, that I have reviewed the Complaint, and that the facts therein are true and correct to the best of my knowledge, information and belief.

I declare under penalty of perjury that the foregoing is true and correct.

DATE: 7/30/07

  
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Geoffrey Wren