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First Amended Consolidated Class Action Complaint for Violation of the Federal Securities Laws

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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

PAUL RUTHFIELD, et al., On Behalf of Themselves and All Others Similarly Situated, Plaintiffs, vs. ELLEN M. HANCOCK, R. MARSHALL CASE, SAM S. MOHAMAD, DICK STOLTZ, HERBERT A. DOLLAHITE, ADAM W. WEGNER, BEVERLY BROWN, WILLIAM YEACK, GOLDMAN, SACHS & CO., MERRILL LYNCH & CO., MORGAN STANLEY DEAN WITTER AND J.P. MORGAN, Defendants. In re: EXODUS COMMUNICATIONS, INC. SECURITIES LITIGATION This Document Relates To: ALL ACTIONS.	)	Master File No. C-01-2661-MMC <u>CLASS ACTION</u> FIRST AMENDED CONSOLIDATED CLASS ACTION COMPLAINT FOR VIOLATION OF THE FEDERAL SECURITIES LAWS <u>DEMAND FOR JURY TRIAL</u>

NATURE OF THE CASE

1. This is a class action on behalf of all purchasers of the securities of Exodus Communications, Inc. ("Exodus" or the "Company") between April 20, 2000 and September 25, 2001, inclusive (the "Class Period"), seeking remedies under the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act"). During the Class Period, the defendants identified herein participated in an egregious accounting fraud designed to deceive investors of Exodus, including, among other things, falsifying Exodus' financial results by wrongfully booking revenues from orders that had been cancelled, invoicing customers for services prior to installation, entering into barter transactions designed solely to boost revenue, and failing to appropriately credit customers when required. Defendants also made highly positive statements concerning Exodus during the Class Period, even though they were aware of serious problems then impacting Exodus, including large amounts of bad debt from uncreditworthy customers and lack of demand for their services.

2. By engaging in this fraud, defendants were able to profit through personal sales of their Exodus stock, collectively selling over 1.4 million shares of stock for proceeds of over ***$72.5 million***. Defendants were also able to maintain a high credit rating and to obtain much needed funding for Exodus, including successfully completing several offerings for proceeds to Exodus of almost ***$2 billion***. Also, by engaging in this fraud, defendants were able to continue to meet Wall Street expectations, continue Exodus' acquisition strategy, delay Exodus' bankruptcy, and maintain their positions, compensation and reputations.

3. Exodus filed for bankruptcy on September 26, 2001. On September 25, 2001, the day prior to its bankruptcy filing, the *Wall Street Journal* published an article stating that Exodus' bankruptcy was forthcoming, causing Exodus' stock price to drop to $0.17 on record volume of 193 million shares. Trading on Exodus shares was halted on September 26, 2001. Upon resumption of trading on October 5, 2001, Exodus stock dropped further to $0.10 on high volume of 72 million shares. During the Class Period, Exodus' stock traded for as high as $179 per share.

4. As a result of defendants' fraud, plaintiffs and other investors who acquired Exodus securities during the Class Period acquired their securities at artificially inflated prices and were damaged thereby.

JURISDICTION AND VENUE

5. This Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. §§1331 and 1337, §22(a) of the Securities Act, and §27 of the Exchange Act.

6. This action arises under §§11 and 15 of the Securities Act and §§10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder (17 C.F.R. §240.10b-5).

7. Venue is proper in this district pursuant to §27 of the Exchange Act and 28 U.S.C. §1391(b) because the acts charged herein, including the dissemination of materially false and misleading information, occurred in this district. Exodus was located in Santa Clara, California.

8. In connection with the conduct complained of herein, defendants used instrumentalities of interstate commerce, including the mail and interstate telephone communications, and the facilities of a national securities exchange.

THE PARTIES

9. Lead Plaintiffs Michael Klein, Teresi Trucking, Inc., and William H. Friedman purchased Exodus securities during the Class Period and were damaged thereby. Plaintiff Thomas Welsh purchased Exodus shares during the Class Period traceable to Exodus' February 6, 2001 Registration Statement and Prospectus for its secondary offering. Plaintiff Martin Fox purchased notes during the Class Period issued in connection with Exodus' February 6, 2001 note offering.

10. Numerous additional plaintiffs purchased Exodus securities on the open market during the Class Period and were damaged thereby. These additional plaintiffs, if needed, have stated their willingness and ability to serve as class representatives.

11. Defendant Ellen M. Hancock ("Hancock") was Exodus' Chief Executive Officer from September 1998, its Chairman of the Board of Directors from June 2000, and its director from April 1998. She also served as the President of Exodus from March 1998 to June 2000 and as the acting Vice President of Marketing of Exodus from July 1998 to October 1998. She resigned from the Company in September 2001. She had principal responsibility for important issues facing Exodus' business, its customer base, and its ability to achieve growth in its revenue and business. Hancock participated in conference calls, gave interviews to reporters, and participated in drafting the Company's press releases and SEC filings. Hancock made many of the statements alleged herein to be false and misleading. During the Class Period, Hancock sold 371,671 shares of Exodus stock at artificially inflated prices of as high as $72.87 per share, for proceeds of over $8 million.

12. Defendant R. Marshall Case ("Case") was Exodus' Executive Vice President of Finance and its Chief Financial Officer from January 2000 until his resignation in May 2001. Case participated in conference calls, and in drafting the Company's press releases and SEC filings and signed many such documents. Case made many of the statements alleged to be false and misleading. During the Class Period, Case sold 200,000 shares of Exodus stock at artificially inflated prices of as high as $66.31 per share, for proceeds of over $13 million.

13. Defendant Sam S. Mohamad ("Mohamad") was Exodus' President of Worldwide Sales from January 2001. Previous to that role, he served as Exodus' President of Worldwide Sales and International Field Operations from June 2000 to January 2001, and as the Executive Vice President of Worldwide Sales from December 1998 to June 2000. Mohamad was directly involved in the fraud alleged herein, and he participated in drafting the Company's press releases and SEC filings. During the Class Period, Mohamad sold 247,971 shares of Exodus stock at artificially inflated prices of as high as $87.70 per share, for proceeds of over $17 million.

14. Defendant Dick Stoltz ("Stoltz") was the temporary Chief Financial Officer of Exodus during part of the Class Period. During the Class Period, Stoltz participated in conference calls and in drafting the Company's press releases and SEC filings, and directly participated in Exodus' acquisition of GlobalCenter. Stoltz made many of the statements alleged herein to be false and misleading. Stoltz was a co-founder of Exodus, and served as its Executive Vice President of Finance and Chief Operating Officer prior to the Class Period.

15. Defendant Herbert A. Dollahite ("Dollahite") was Exodus' Executive Vice President of Customer Services and Support and Quality from November 1998, and Vice President of Quality from June 1998 to November 1998. Dollahite was involved in the day-to-day operations of the Company, including issues pertaining to Exodus' Internet Data Center ("IDC") build-out and integration of GlobalCenter's operations with Exodus. He also reviewed the Company's SEC filings and press releases and had the ability to revise them prior to their publication. He spoke to analysts concerning the Company during the Class Period, Dollahite sold over 96,800 shares of Exodus stock at artificially inflated prices of as high as $7.88 per share, for proceeds of approximately $762,784.

16. Defendant Adam W. Wegner ("Wegner) was Exodus' Senior Vice President of Legal and Corporate Affairs from February 2000, and Exodus' General Counsel and Secretary of Exodus from July 1997. He also served as Exodus' Vice President from October 1998 to January 2000. Wegner was involved in the day-to-day operations of the Company, and was involved in issues including customer demand and Company strategy. He reviewed the Company's SEC filings and press releases and had the ability to revise them prior to their publication. During the Class Period, Wegner sold over 219,630 shares of Exodus stock at artificially inflated prices of as high as $85.00 per share, for proceeds of approximately $12 million.

17. Defendant Beverly Brown ("Brown") was Exodus' Executive Vice President and Chief Marketing Officer from October 1999 until her resignation in May 2001. Brown participated in the day-to-day operations of the Company, reviewed the Company's SEC filings and press releases and had the ability to revise them prior to their publication. During the Class Period, Brown sold 201,360 shares of Exodus stock at artificially inflated prices of as high as $65.88, for proceeds of over $13 million.

18. Defendant William Yeack ("Yeack") was Exodus' Executive Vice President of Managed and Professional Services from August 1999. During the Class Period, Yeak participated in the day-to-day

operations of the Company, reviewed the Company's SEC filings and press releases and had the ability to revise them prior to their publication. During the Class Period, Yeak sold 117,600 shares of his Exodus stock at artificially inflated prices of $64.91 per share, for proceeds of over $7.63 million.

19. Defendants Hancock, Case, Wegner, Dollahite, Mohamad, Stoltz, Yeack and Brown (collectively, "Individual Defendants"), were officers of Exodus during the Class Period. As of April 30, 2001, there were 554,028,272 shares of Exodus common stock outstanding and traded in an efficient market on the NASDAQ National Market System. On September 26, 2001, Exodus filed for Chapter 11 bankruptcy protection, and is not named as a defendant herein due to its bankruptcy and liquidation.

20. The Individual Defendants are liable for the false statements pleaded herein. Where a false and misleading oral statement was made by an individual defendant, the particular individual who made the statement is liable for the statement. Where statements were made as a group, all of the individuals are liable for the false statements as those statements were "group-published" information for which they were responsible.

21. Defendant Goldman, Sachs & Co. ("Goldman") served as an underwriter for the February 6, 2001 Exodus common stock offering and the February 6, 2001 offering of 5-1/4% convertible subordinated notes.

22. Defendant Merrill Lynch & Co. (Merrill Lynch") served as an underwriter for the February 6, 2001 Exodus common stock offering and the February 6, 2001 offering of 5-1/4% convertible subordinated notes.

23. Defendant Morgan Stanley Dean Witter ("Morgan Stanley") served as an underwriter for the February 6, 2001 Exodus common stock offering and the February 6, 2001 offering of 5-1/4% convertible subordinated notes.

24. Defendant J. P. Morgan served as an underwriter for the February 6, 2001 Exodus common stock offering and the February 6, 2001 offering of 5-1/4% convertible subordinated notes.

BACKGROUND TO THE COMPANY'S BUSINESS

25. Exodus owned and operated Internet Data Centers ("IDCs"), which provided physical space for Exodus' clients to place their servers, along with broadband connectivity and other services needed to run and operate their Internet operations.

26. Exodus began offering server hosting and Internet connectivity in late 1995, and opened its first IDC in August 1996. The Company went public in March 1998. Billed as a fast growth Company, its high stock price depended upon its growth rate. Exodus' stock price went up 985% in 1999, and the stock split four times in just three years of trading.

27. Beginning in early 2000, defendants recognized that the market was weakening and that Exodus needed to continue to show exponential revenue growth in order to maintain its credit rating and to obtain additional funding. Defendants also recognized that they would personally profit by selling their holdings of Exodus stock at artificially inflated prices. Thus, at the beginning of 2000, defendants embarked on a scheme to defraud by, among other things, entering into contracts with non-creditworthy customers, falsifying Exodus' financial results by invoicing customers for services prior to installation, booking revenue from orders that had been cancelled, entering into barter transactions to boost revenue,

and failing to appropriately credit customers when required. Defendants also made numerous positive statements about Exodus' business condition and prospects which were false.

28. As a result of Exodus' improper financial practices, its revenues grew from $52.7 million in 1998, to $242 million in 1999, and to purportedly $818 million in 2000.

FALSE AND MISLEADING STATEMENTS

29. On April 20, 2000, Exodus announced its first quarter financial results, and that the Company had finally achieved earnings before net interest, taxes, depreciation, and amortization ("EBITDA") profitability, as follows:

> Exodus Communications, Inc. (NASDAQ:EXDS) today reported ***first quarter 2000 revenues of $134.1 million, a 346 percent increase over first quarter 1999, and a 32 percent increase over fourth quarter 1999***.
>
> ***Exodus reported a $1.7 million EBITDA profit*** (earnings before net interest expense, income taxes, depreciation, amortization and other noncash charges) for first quarter 2000, compared to an EBITDA loss of $12.6 million (excluding one-time acquisition related costs) for fourth quarter 1999.
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> Net loss was $42.3 million in first quarter 2000, or $0.23 per share, excluding the impact of amortization of goodwill and intangible assets, and the impact of one-time expenses related to the conversion of convertible subordinated debt. Net loss for the quarter was $58.4 million, or $0.32 per share, compared with a net loss of $52.9 million, or $0.30 per share, in fourth quarter 1999, and a net loss of $23.2 million, or $0.14 per share, in first quarter 1999.
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> "***This period marked the first quarter that Exodus achieved EBITDA profitability***," said Ellen Hancock, president and CEO. "***This important milestone indicates the strength of our business model and our ability to generate a return on our investments***."
>
> "***In addition, we added 545 new IDC customers bringing our total to 2,830 IDC customers,***" said Hancock. "At the same time, our average annualized revenue per IDC customer increased to $220,000 in the first quarter, compared to $196,000 in fourth quarter 1999."
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> "***Not only did Exodus go EBITDA positive this quarter but it also was an extremely strong quarter from a new bookings standpoint***," said R. Marshall Case, executive vice president, finance and chief financial officer. "***Exodus booked $174 million of new annualized recurring revenue in the first quarter. Assuming the backlog is installed today and combined with our current installed customer base, the annualized revenue run rate of recurring revenue would exceed $632 million, which represents a 38 percent increase from the prior quarter***."
>
> "***In order to meet growing market demand, we continue to expand*** our robust suite of services in systems, networks, content distribution, security, storage management, stress testing and performance monitoring," said Hancock.

30. The foregoing statements were false and misleading when made. As set forth below in ¶¶105-129, 152-191, defendants misrepresented Exodus' financial results and failed to disclose that Exodus engaged in improper revenue recognition practices. Further, despite the statement that there was growing demand, as set forth below in ¶¶133-144, defendants by this time were already aware that demand for the Company's products was waning. Defendants also misrepresented the number of customers by including customers who were not active, who had cancelled and who had no ability to pay.

31. As a result of defendants' positive but false statements about Exodus, Exodus was able to continue its acquisition growth strategy. On April 21, 2000, Exodus invested in the common stock of Mirror Image, a privately held provider of content distribution services, for cash payment of $75 million and 7,516,535 shares of its common stock. This investment, at close, was valued at approximately $391.6 million, including certain professional fees of approximately $6.5 million.

32. On May 12, 2000, Exodus filed its Form 10-Q for the quarterly period ended March 31, 2000, signed by defendants Hancock and Case. The 10-Q showed that Exodus had achieved the following financial results:

Cash and cash equivalents	$863 million
Accounts receivable	$90 million
Revenues	$134 million

With respect to the Company's financial presentation, the Form 10-Q stated:

> The accompanying unaudited condensed consolidated financial statements ***have been prepared in accordance with generally accepted accounting principles*** for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not contain all of the information and footnotes required by generally accepted accounting principles for complete financial statements. ***In the opinion of management, the accompanying unaudited condensed consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of the Company's financial position as of March 31, 2000 and the results of its operations and cash flows for the three-month periods ended March 31, 2000 and 1999***.

With respect to the Company's revenues, the Form 10-Q also stated:

> ***Our revenues increased 346% to $134.1 million for the three month period ended March 31, 2000 from $30.1 million in the same respective period of the prior year***. Revenues generated by Internet Data Centers increased to $109.9 million for the three month period ended March 31, 2000 from $28.5 million in the same respective period of the prior year. This growth in revenues was primarily the result of opening new Internet Data Centers, expanding existing Internet Data Centers, increases in the number of new customers and increases in revenues from existing customers. In addition, revenues generated by professional services increased to $24.3 million for the three month period ended March 31, 2000 from $1.6 million in the same respective period of the prior year which was primarily due to increases in revenues arising from increases in the number of customers and revenues generated from the acquisition of Cohesive in July 1999.

33. The foregoing statements were false and misleading when made. As set forth below in ¶¶105-129, 152-191, contrary to defendants' representations, Exodus' financial results did not conform with Generally Accepted Accounting Principles ("GAAP"). Further, the Company's financial results were overstated for the reasons set forth in ¶¶105-129, 152-191.

34. On June 23, 2000, *The Business Journal* published an article that quoted defendant Wegner saying that "***our biggest challenge is meeting the demand in front of us***," that "***we are able to demonstrate we have a viable business model***," and that "***[once the infrastructure is in place] it does not take long for services to generate positive cash flow***."

35. The foregoing statements made by Wegner were false and misleading when made. As set forth in ¶¶133-144 below, defendants by this time were already aware that demand for Exodus' services was waning, that its business model was broken, and that it would have difficulty creating positive cash flow because of Exodus' vast numbers of non-creditworthy customers.

36. As a result of defendants' positive but false statements, Exodus' credit rating was raised by Standard & Poors ("S&P"). On June 26, 2000, in announcing that its credit rating was raised by S&P, Exodus stated the following:

> Exodus Communications, Inc. (Nasdaq:EXDS) a leading provider of complex Internet hosting services, today announced that Standard & Poor's (S&P) has raised its corporate credit and senior unsecured debt ratings to single B from single B minus and its subordinated debt rating on the Company to triple C plus from triple C. In addition, S&P assigned its single B rating to Exodus Communications' recently announced $600 million senior note issue due 2010. This transaction has not yet closed nor has the price been determined.
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> According to S&P, the ratings upgrade, "is based on increased scale in the company's operations, demonstrated performance of its operating model over the past year, and adequate near-term financial flexibility." S&P further commented that the Company's ratings outlook is stable.
>
> "We are pleased with the ratings upgrade we have received from Standard & Poor's," said Ellen M. Hancock, Exodus(R) chairman and CEO. "***We believe this upgrade is a reflection of our continued success and strong financial and business management skills***."

37. As further result of defendants' false and misleading statements, on June 28, 2000, Exodus was able to sell approximately $1.2 billion principle amount in a private offering consisting of $1 billion of 11-5/8% senior notes due 2010 and Euro 200 million aggregate principle amount of 11-3/8% senior notes due 2008.

38. On July 19, 2000, Exodus announced its second quarter 2000 financial results, as follows:

> Exodus Communications, Inc. (Nasdaq:EXDS) today reported ***second quarter 2000 revenues of $179.6 million, a 34 percent increase over first quarter 2000, and a 321 percent increase over second quarter 1999***.
>
> Exodus reported an $8.6 million EBITDA profit (earnings before net interest expense, income taxes, depreciation, amortization and other noncash charges) for second quarter 2000, compared to a $1.7 million EBITDA profit for the first quarter 2000.

> Net loss was $42.5 million in second quarter 2000, or $0.10 per share, excluding the impact of amortization of goodwill and intangible assets. Total net loss for the quarter was $51.3 million, or $0.12 per share, compared with a net loss of $58.4 million, or $0.16 per share, in first quarter 2000, and a net loss of $22.6 million, or $0.07 per share, in second quarter 1999. All references to earnings per share and share count set forth in this press release are adjusted to reflect Exodus' recent two-for-one stock split which was effected on June 20, 2000.
>
> "***Not only was the second quarter another exceptional period for Exodus from a revenue, EBITDA and EPS standpoint, but it also marked achievements in a number of key metrics in our business," said Ellen M. Hancock, chairman and CEO. "In the second quarter***, our average revenue per IDC customer increased to $259,000 compared to $220,000 in the first quarter 2000. ***Additionally, we surpassed the 3,000th IDC customer mark, ending the period with 3,333 IDC customers***."
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> "***The second quarter was also an extremely strong quarter from a new bookings standpoint, which is evidence of the growing demand for our services***," said Hancock. "***Exodus booked $245 million of new annualized recurring revenue in the second quarter. Assuming the backlog is installed today and combined with our current installed customer base, the annualized revenue run rate of recurring revenue would exceed $877 million, which represents a 39 percent increase from the prior quarter***."
>
> "***As for improvement to our financial performance, both EBITDA and gross margin dollars increased significantly***," said R. Marshall Case, executive vice president, finance and chief financial officer. "Contributing to these results were three new Internet Data Centers - Austin, Boston 2 and New Jersey 2 - which turned EBITDA positive ahead of our same store model of 15 months. ***Our second quarter performance is evidence of the strength of our business model and management's ability to execute***."

39. The foregoing statement was false and misleading when made. As set forth in ¶¶105-129, 152-191 below, defendants misrepresented Exodus' financial results and omitted to disclose that Exodus engaged in improper revenue recognition practices. Further, despite statements that there was growing demand, as set forth below in ¶¶133-144, defendants by this time were already aware that demand for the Company's products was waning. Defendants also misrepresented the number of customers by including customers who were not active, who had cancelled and who had no ability to pay.

40. Based on defendants' false and misleading statements, on or about July 28, 2000, S&P assigned its B+ bank loan rating to the Company's $600 million senior secured credit facility. In addition, S&P also reaffirmed its B corporate credit and B senior unsecured note ratings on Exodus because "Exodus' profile benefits from a growing number of enterprise customers, who comprise nearly half of revenue, as well as a base of leading Internet companies whose business needs are expanding as electronic commerce becomes more widespread." S&P further commented that the Company's ratings outlook is stable. According to an Exodus press release regarding the rating:

> "We are pleased with the new rating and the reaffirmation of the existing ratings we have received from Standard & Poor's," said Ellen M. Hancock, chairman and CEO of Exodus. "***We continue to believe these ratings are a reflection of Exodus' growth and strong financial and business management skills***."

41. On August 14, 2000, Exodus filed its Form 10-Q for the quarterly period ended June 30, 2000, signed by defendants Hancock and Case. The 10-Q showed that Exodus had achieved the following financial results:

Cash and cash equivalents	$520 million
Accounts receivable	$108 million
Revenues	$179 million

With respect to the Company's financial presentation, the Form 10-Q stated:

> The accompanying unaudited condensed consolidated financial statements ***have been prepared in accordance with generally accepted accounting principles*** for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not contain all of the information and footnotes required by generally accounting principles for complete financial statements. ***In the opinion of management, the accompanying unaudited condensed consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of the Company's financial position as of June 30, 2000 and the results of its operations for the three and six month periods ended June 30, 2000 and 1999 and cash flows for the six-month period ended June 30, 2000 and 1999***.

With respect to the Company's revenues, the Form 10-Q also stated:

> ***Our revenues increased 321% and 331% to $179.6 million and $313.7 million, respectively, for the three-month and six-month periods ended June 30, 2000 from $42.6 million and $72.7 million in the same periods of the prior year***. Revenues generated by Internet Data Centers increased to $150.6 million and $260.5 million, respectively, for the three-month and six-month periods ended June 30, 2000 from $38.7 million and $67.2 million in the same periods of the prior year. This growth in revenues was primarily the result of opening new Internet Data Centers, expanding existing Internet Data Centers, increases in the number of new customers and increases in revenues from existing customers. In addition, revenues generated by professional services increased to $29.0 million and $53.2 million for the three-month and six-month periods ended June 30, 2000 from $3.9 million and $5.5 million in the same periods of the prior year which was primarily due to increases in revenues arising from increases in the number of customers and revenues generated from the acquisition of Cohesive in July 1999.

42. The foregoing statements were false and misleading when made. As set forth below in ¶¶105-129, 152-191, contrary to defendants' representations, Exodus' financial results did not conform with GAAP. Further, the Company's financial results were overstated for the reasons set forth in ¶¶105-129, 152-191.

43. As a result of defendants' positive but false statements concerning Exodus, Exodus was able to continue its acquisition growth strategy. On September 28, 2000, Exodus entered into a definitive merger agreement to acquire GlobalCenter Holding Co., an indirect wholly owned subsidiary of Global Crossing North America, Inc. As part of the transaction, Exodus agreed to form a joint venture with Asia Global Crossing Ltd., an indirect wholly owned subsidiary of Global Crossing Ltd. At the effective time of the merger, Exodus would issue to GlobalCenter stockholders shares of its common stock equal to $6.525

billion divided by the average closing price of Exodus common stock for the ten trading days prior to the closing of the transaction, subject to a collar.

44. On October 19, 2000, Exodus announced its third quarter financial results in a press release, as follows:

> Exodus Communications, Inc. (Nasdaq:EXDS) today reported ***third quarter 2000 revenues of $229.6 million, a 28 percent increase over the second quarter 2000, and a 238 percent increase over the third quarter 1999***.
>
> EBITDA profit (earnings before net interest expense, income taxes, depreciation, amortization and other noncash charges) increased 134 percent to $20.2 million for the third quarter 2000, compared to an $8.6 million EBITDA profit for the second quarter 2000, and a $7.5 million EBITDA loss in the third quarter 1999.
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> Net loss excluding the impact of amortization of goodwill and intangible assets was $60.6 million in the third quarter 2000, or $0.14 per share. Net loss for the quarter was $69.5 million, or $0.17 per share, compared with a net loss of $51.3 million, or $0.12 per share, in the second quarter 2000, and a net loss of $31.5 million, or $0.09 per share, in the third quarter 1999.
>
> "Enterprise customers currently represent 53 percent of our total revenues and bookings compared to 39 percent one year ago, as we continue to see more Fortune 1000 companies choose Exodus as the web hosting provider for their mission-critical Internet operations," said Ellen M. Hancock, Chairman and CEO. "***In the third quarter, we added 414 Internet Data Center (IDC) customers bringing our total IDC customer count to 3,747***. Our average annualized revenue per IDC customer increased to $299,000 in the third quarter compared to $259,000 in the second quarter, reflecting substantial growth from both new and existing customers.
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> * * *
>
> ***Exodus booked $270 million of new annualized recurring revenue from both new and existing customers in the third quarter. Assuming the backlog is installed today and combined with Exodus' current installed customer base, the annualized revenue run rate of recurring revenue would exceed $1.15 billion, which represents a 31 percent increase from the prior quarter***.
>
> "***In order to meet growing market demands*** in Chicago and Southern California, we opened two IDCs, which represent 560,000 gross square feet, since the second quarter," said R. Marshall Case, executive vice president, finance and chief financial officer. "In the fourth quarter, we expect to open five additional IDCs, representing approximately 1.2 million gross square feet, in the Washington, D.C., Santa Clara, New Jersey, Seattle and Boston markets. Overall, we are on track to have an aggregate of 3.9 million gross square feet in operation by the end of the year."
>
> Third Quarter Highlights
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> Additional operational and financial highlights for the third quarter are as follows:

- Approximately 40 percent of the world's top web sites are hosted at Exodus.
- Over 62,000 servers are hosted at Exodus worldwide.
- Revenue mix consisted of
  44 percent hosting services
  20 percent Internet connectivity
  36 percent managed and professional services.
- Gross margins were:
  31 percent of revenue or $71.1 million
  47 percent of revenue or $108.2 million, excluding depreciation and amortization.
- 18 IDCs are currently EBITDA positive, up from 17 in the second quarter:
  The Atlanta IDC turned EBITDA positive in eight months.
- ***Cash and marketable securities were $1.2 billion at quarter end***.
- ***Annualized customer churn was less than two percent***
- Capital expenditures were $521 million and principally represented investments to build and expand IDCs.
- ***Days Sales Outstanding was 53 days in the third quarter and is within Exodus' target range***.

* * *

Exodus expects revenue for the fourth quarter 2000 to be in the range of $270 million to $280 million.

EBITDA profit is expected to increase from 9 percent of revenue in the third quarter to 11 to 13 percent of revenue for the fourth quarter 2000.

Gross margin for fourth quarter 2000 is expected to be approximately 32 percent of revenue, plus or minus one point.

Operating expenses for fourth quarter 2000 are expected to decline as a percentage of revenue and represent 42 percent, plus or minus one point.

Exodus expects net interest expense to be $47 million to $50 million for the fourth quarter 2000. The rate of sequential growth of net interest expense will be affected by the timing of Exodus' anticipated bank line, which is expected to close in the first half of the fourth quarter. Net interest expense is dependent in part on the timing of capital expenditures, future borrowings, interest rates, cash balances, and the realization of gains on investments.

Exodus expects a net loss, excluding the impact of amortization of goodwill and intangible assets, of $60 million to $70 million, or $0.15 per share, plus or minus $0.01 per share, for the fourth quarter 2000.

Depreciation is expected to be approximately $51 million for the fourth quarter 2000 and will be a function of capital spending, which is expected to be slightly in excess of $400 million for the fourth quarter 2000.

On a stand-alone basis, Exodus expects to achieve significant growth and financial results for 2001 as follows:

- ***Revenues of approximately $1.8 billion***
- Gross margins of 36 percent to 39 percent of revenues
- EBITDA margin of 19 percent to 22 percent
- Net loss, excluding the impact of amortization of goodwill, of 10 percent to 13 percent
- Capital expenditures of $800 million to $1.0 billion
- Additional IDC capacity of 1.5 million to 2.0 million gross square feet

> "***Overall, the third quarter marked significant financial achievements as we continued to see strong customer demand for Exodus' core complex web hosting and managed services business," said Ms. Hancock. "Exodus surpassed $1 billion in annualized recurring revenue, our average revenue per IDC customer more than doubled from 18 months ago, and the company reported record EBITDA performance***."

45. The foregoing statements were false and misleading when made. As set forth below in ¶¶105-129, 152-191, Exodus' financial results were false due to improper revenue recognition practices and failure to conform with GAAP. Additionally, as set forth below in ¶¶131-132, defendants' forecasts were made without basis. Further, as set forth below in ¶¶133-132, defendants' statements concerning demand were false and misleading because by this time, defendants were already well aware that demand for Exodus' services was waning. Defendants also misrepresented the number of customers by including customers who were not active, who had cancelled and who had no ability to pay.

46. As a result of defendants' positive but false statements, on October 31, 2000, Exodus was able to enter into senior secured credit facilities with a syndicate of banks under which, subject to compliance with the Company's existing indentures and covenants contained in the credit agreement and the satisfaction of customary borrowing conditions, the Company was permitted to borrow up to $600 million. The credit facilities include a revolving credit facility in the aggregate amount of $225 million and two long term loan facilities in the aggregate amount of $375 million. A portion of the revolving facility was available at the Company's option, in the form of letters of credit. On October 31, 2000, the Company borrowed an initial $150 million against the term loan facilities. Pursuant to the credit agreement dated October 31, 2000 between Exodus and Chase Manhattan Bank, Exodus had to maintain specific financial ratios, including certain minimum EBITDA each of its quarterly periods; a certain leverage ratio; a certain ratio of annualized consolidated EBITDA to consolidated cash interest expense; could not exceed certain capital expenditures; and could not permit unrestricted cash to be less than $100 million on any date on which the leverage ratio was greater than 4.0 to 1.0.

47. On November 14, 2000, Exodus filed its Form 10-Q for the quarterly period ended September 30, 2000, signed by defendants Hancock and Case. The 10-Q showed that Exodus achieved the following financial results as of the end of its third quarter 2000:

Cash and cash equivalents	$1.24 billion
Accounts receivable	$134 million
Revenues	$229 million

The Form 10-Q stated, with regards to its financial statements, that:

> The accompanying unaudited condensed consolidated financial statements ***have been prepared in accordance with generally accepted accounting principles*** for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly,

> they do not contain all of the information and footnotes required by generally accounting principles for complete financial statements. ***In the opinion of management, the accompanying unaudited condensed consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of the Company's financial position as of September 30, 2000 and the results of its operations for the three-month and nine-month periods ended September 30, 2000 and 1999, and cash flows for the nine-month periods ended September 30, 2000 and 1999***.

With regards to revenues, the Form 10-Q stated:

> ***Revenues (other than installation fees, equipment sales to customers and certain professional services), are generally billed and recognized ratably over the term of the contract, which is generally one year. Installation fees are typically recognized at the time the installation occurs, and equipment sales revenue are typically recognized when the equipments is delivered to the customer or placed into service at an Internet Data Center. The Company sells third-party equipment to its customers as an accommodation to facilitate their purchase of services. Sales of third-party equipment account for less than 10% of total revenues for all periods presented. One-time professional service fees are typically recognized when its services are rendered***.
>
> ***Our revenues increased 238% and 286% to $229.6 million and $543.3 million, respectively, for the three-month and nine-month periods ended September 30, 2000 from $68.0 million and $140.8 million in the same periods of the prior year***. Revenues generated by Internet Data Centers increased to $193.9 million and $454.4 million, respectively, for the three-month and nine-month periods ended September 30, 2000 from $52.4 million and $119.7 million in the same periods of the prior year. This growth in revenues was primarily the result of adding approximately 400 new Internet Data Center customers, growth in average annualized revenue per customer to $299,000, expanding existing Internet Data Centers and opening a new Internet Data Center. In addition, revenues generated by professional services increased to $35.7 million and $89.0 million for the three-month and nine-month periods ended September 30, 2000 from $15.6 million and $21.1 million in the same periods of the prior year which was primarily due to increases in revenue arising from increases in the number of customers and revenues generated from the acquisition of Cohesive in July 1999.

48. The foregoing statements were false and misleading when made. As set forth below in ¶¶105-129, 152-191, Exodus' financial results were false because the Company engaged in improper revenue recognition practices. Further, as set forth below in ¶¶105-129, 152-191, contrary to defendants' representations, Exodus' financial results did not conform with GAAP.

49. On December 7, 2000, Exodus filed a Schedule 14A Proxy Statement in connection with the acquisition of GlobalCenter. In the letter to shareholders contained in the Proxy Statement by Ellen Hancock, Hancock represented that:

> The Exodus board of directors, after careful consideration, has approved a merger of a wholly owned subsidiary of Exodus with and into GlobalCenter Holding Co. ***The board of directors believes that this proposed merger will accelerate the pace of Exodus' global expansion and enhance its position as a leader in complex Web hosting and managed***

services.

Exodus believes that combining Exodus and GlobalCenter Holding Co., two leading Web hosting providers, will enhance Exodus' global Internet Data Center infrastructure, strengthen Exodus' customer support, sales and professional services organizations, expand Exodus' customer base and improve Exodus' competitive position. In addition, Exodus believes that the merger will give Exodus a strong presence in Asia, a greater geographic presence worldwide and a stronger worldwide network.

50. The foregoing statements were false and misleading when made. Contrary to defendants' representation that the GlobalCenter acquisition would enhance Exodus' business, as set forth below in ¶¶145-147, defendants were advised against the GlobalCenter acquisition by Exodus' internal due diligence team.

51. As a result of defendants' positive but false statements, on December 18, 2000, Exodus was added to the NASDAQ-100 Index. In a press release announcing this addition on December 11, 2000, defendants stated:

"Exodus is proud and honored to be added to the Nasdaq-100 Index," said Ellen M. Hancock, Exodus' chairman and CEO. "We believe that Exodus' inclusion in the index not only ***demonstrates the strength of the Company, but also the complex web hosting market***."

52. As a result of defendants' positive but false statements, Exodus was able to continue its growth by acquisition strategy. Defendants' positive statements about the GlobalCenter acquisition caused Exodus' shareholders to approve the acquisition, and on January 10, 2001, Exodus acquired GlobalCenter, a provider of complex Internet hosting services, from Global Crossing Ltd. Exodus issued 108,157,200 shares of its common stock and assumed certain GlobalCenter and Global Crossing Ltd. stock options in connection with the acquisition.

53. On January 10, 2001, Exodus issued a press release announcing that it had completed the acquisition of GlobalCenter. According to the announcement:

Ellen Hancock, chairman and chief executive officer of Exodus, said, "***This combination gives us the scale, scope and global presence to extend our leadership position as a mission-critical Web hosting and managed services provider***. With GlobalCenter, we have a far larger customer base and an expanded pool of highly skilled and dedicated employees. Combined, we will have approximately 4000 customers to cross-sell Exodus managed services. Our strategic partners include Cisco, Compaq, Dell, Inktomi, Microsoft, Oracle and Sun Microsystems. These characteristics set Exodus apart from other companies in our industry and will enable us to continue to provide leading managed Web hosting solutions and services to our customers while expanding our worldwide network of Internet Data Centers."

54. The foregoing statement was false and misleading when made. Contrary to defendants' representation that the GlobalCenter acquisition would enhance Exodus' business, as set forth below in ¶¶145-147, defendants were advised against the GlobalCenter acquisition by Exodus' internal due diligence team.

55. On January 23, 2001, Exodus and SANrise, Inc. together issued a press release announcing that SANrise had acquired the assets of Exodus' DataVault Storage Service. According to the press release, SANrise, a privately-held provider of storage solutions had acquired certain assets of, and would be assuming operations for, the service delivery and customer support of the Exodus DataVault tape back-up and restore service business. Terms of the agreement include an Exodus equity investment in SANrise and further expansion of the global alliance between the two companies.

56. On January 24, 2001, Exodus issued a press release announcing its fourth quarter 2000 and fiscal 2000 annual financial results. The press release stated as follows:

> ***Exodus Communications, Inc. (Nasdaq:EXDS) today reported fourth quarter 2000 revenues of $280.4 million, a 22 percent increase over the third quarter 2000, and a 177 percent increase over the fourth quarter 1999***.
>
> EBITDA profit (earnings before net interest expense, income taxes, depreciation, amortization, and other noncash charges) increased 31 percent to $26.5 million for the fourth quarter 2000, compared to a $20.2 million EBITDA profit for the third quarter 2000, and a $16.7 million EBITDA loss for the fourth quarter 1999.
>
> Net loss excluding the impact of amortization of goodwill and intangible assets was $55.8 million for the fourth quarter 2000, or $0.13 per share, compared with a net loss excluding the impact of amortization of goodwill and intangible assets of $60.6 million, or $0.14 per share, for the third quarter 2000, and a net loss excluding the impact of amortization of goodwill and intangible assets of $48.2 million, or $0.14 per share, for the fourth quarter of 1999. Net loss for the quarter was $65.2 million, or $0.15 per share.
>
> ***Revenues for the fiscal year ended December 31, 2000 increased 238 percent to $818.4 million compared to $242.1 million in the prior year***. Exodus(R) reported an EBITDA profit for 2000 of $45.0 million compared to an EBITDA loss of $44.7 million for the prior year. Net loss for 2000 excluding the impact of amortization of goodwill and intangible assets was $221.5 million, or $0.54 per share, compared to a net loss excluding the impact of amortization of goodwill and intangible assets of $120.9 million, or $0.36 per share, for the prior year.
>
> "Enterprise customers currently represent 57 percent of our total revenues and bookings compared to 42 percent one year ago," said Ellen M. Hancock, chairman and CEO. "Our enterprise customers include British Airways; Hearst Interactive Media; Merrill Lynch & Company; Microsoft Corporation; Novell, Inc.; RR Donnelley & Sons; Sun Microsystems; and Virgin. ***We are also continuing to see strong demand for our services from other existing customers*** including Adobe Systems Benelux BC; Andersen Corporate Tax Solutions; eBay, Inc.; Franklin Templeton Companies; George Lucas Educational Foundation; Lycos, Europe; and Yahoo!"
>
> "Throughout 2000, enterprise customers continued to expand their Web initiatives as a mechanism to lower costs and increase efficiencies," said Hancock. "For example, during the first quarter of 2000 a division of General Electric chose Exodus as its complex web hosting provider. Three quarters later, Exodus now hosts over 30 additional business segments for General Electric."

"Not surprisingly, we have seen evidence of weakness among our dot com customers that is reflected in our increase in the fourth quarter ***churn to three percent annualized***," said Hancock. "However, we do believe that ***enterprises will continue to increase their spending on Web infrastructure and offset the impact of the dot com slowdown***."

* * *

During the fourth quarter, Exodus booked $274 million of new annualized recurring revenue from both new and existing customers. Assuming the backlog is installed today and combined with Exodus' current installed customer base, the annualized revenue run rate of recurring revenue would exceed $1.34 billion.

Average annualized revenue per IDC customer increased to $329,000 in the fourth quarter compared to $299,000 in the third quarter, reflecting substantial growth from both new and existing customers.

In the fourth quarter, Exodus added a net of 245 Internet Data Center (IDC) customers, bringing the total to approximately 4,000 customers worldwide. New customers during the quarter included Janus Capital; Metropolitan Life Insurance Co.; Wall St. Journal.com's vertical Internet sites; Royal Caribbean Cruises, Ltd.; Computerworld, Inc.; W.R. Hambrecht & Co, LLC; IKON Office Solutions/Digital Express; Dominion Bond Rating Service; and FX Alliance LLC.

In order to alleviate supply constraints in key markets, Exodus opened seven IDCs, which represent 1.5 million gross square feet, in the fourth quarter. At the end of the year, Exodus had 30 IDCs worldwide, which represent 4.1 million gross square feet. With the recently completed acquisition of GlobalCenter, Exodus now has 5.1 million gross square feet in 40 IDCs worldwide.

"Revenue from managed and professional services in the fourth quarter broke the $100 million mark, representing 38 percent of revenues, compared to 33 percent in the fourth quarter of 1999," said Hancock. "This growth indicates that our customers are wanting our help in architecting and launching their Internet operations, as well as monitoring, managing and scaling these operations. In the fourth quarter, we further extended the range of our managed services including the areas of storage, content distribution, security, Managed Web Hosting and Web Application Management."

"We are delighted to report that our professional services bookings increased 19 percent from third quarter 2000," said Hancock. "In the fourth quarter, we added numerous professional services customers including The Boeing Company; Societe Generale; Absolute Quality; and SilverCyber Tech Inc., which are not represented in our total IDC customer count. ***This increase in bookings is a leading indicator of web hosting business in 2001***."

Fourth Quarter Highlights:

Additional operational and financial highlights for the fourth quarter are as follows:

- Revenue mix consisted of:
  42 percent hosting services;
  38 percent managed and professional services;
  20 percent Internet connectivity.
- Gross margins were:
  32 percent of revenue or $90.9 million;
  48 percent of revenue or $133.1 million, excluding depreciation and amortization.
- The number of EBITDA positive IDCs increased from 18 to 20.
- ***Cash and marketable securities were $892 million at quarter end, including restricted cash***.
- Capital expenditures were $526 million and principally represented investments to build and expand IDCs.
- ***Days Sales Outstanding was 55 days***.

* * *

Exodus expects revenue for the first quarter 2001 to be in the range of $365 million to $380 million.

Gross margin for the first quarter 2001 is expected to be approximately 22 to 25 percent of revenue. EBITDA is expected to be nominally breakeven.

Exodus expects a net loss, excluding the impact of amortization of goodwill and intangible assets, of $140 million to $150 million, or $0.26 to $0.27 per share.

Exodus expects to achieve significant growth and financial results for 2001 as follows:

- ***Revenues of approximately $2.0 billion to $2.3 billion***.
- Gross margins of 29 percent to 32 percent of revenues.
- EBITDA margin of $300 million to $350 million.
- Net loss, excluding the impact of amortization of goodwill and intangible assets, one time acquisition related charges and gains or losses on equity investments, of $400 million to $450 million, and that the Company anticipates that it will turn positive during the fourth quarter of 2001.
- Capital expenditures of $0.9 billion to $1.1 billion.
- IDC capacity at year-end of approximately 6.7 million gross square feet.

> "Our growth in 2001 will be fueled by further innovation in our Web hosting solutions, continued focus on enterprise customers, and expanding our IDC footprint worldwide," said Hancock. "We believe that with our combination of new services, market leading position, and the expected increase in Internet usage, ***we will be able to successfully manage through short-term fluctuations in the economy and our industry***."

57. The foregoing statements were false and misleading when made. As set forth below in ¶¶105-129, 152-191, Exodus' financial results were false because the Company engaged in improper revenue recognition practices. Further, as set forth below in ¶¶133-144, defendants' statements were false and misleading because defendants were aware that demand for Exodus' service was weak, and because defendants omitted to disclose that many of Exodus' IDCs were far from being full. Defendants also

misrepresented the number of customers by including customers who were not active, who had cancelled and who had no ability to pay.

58. As a result of defendants' positive but false statements, Exodus was able to continue to successfully obtain financing from the public. On February 6, 2001, Exodus conducted a secondary public offering in which it sold 13 million shares of Exodus common stock at $18.50 per share for proceeds of approximately $229 million (net of offering expenses). In connection with this public offering, Exodus issued a Registration Statement and Prospectus containing a number of false and misleading statements. Among other things, defendants stated that "***We believe that the acquisition [of GlobalCenter] enhances our global Internet Data Center infrastructure, strengthens our network, our customer support, sales and professional services organizations, and expands our customer base***." The Prospectus also indicated that Exodus had ***achieved revenues of $280.4 million for the quarter ended December 31, 2000, and $818.4 million for fiscal year 2000***. The Prospectus also included the financial results for Exodus for the nine months ended September 2000. The Prospectus further represented that "[Exodus has] established a diverse base of customers and continues to focus on supporting the ***strong demand from the enterprise market***." Among the representative customers Exodus identified in the Prospectus were ***iBeam Broadcasting Corporation, Inktomi and Storagenetworks***. The Prospectus also falsely claimed that Exodus had 4,500 customers under contract that it was serving.

59. On February 6, 2001, Exodus also issued $500 million of 5-1/4% convertible subordinated notes due February 15, 2008, in which the Company received proceeds of $485.4 million (net of offering expenses). On February 16, 2001, the Company issued an additional $75 million aggregate principle amount of the 5-1/4% notes upon exercise of the underwriters' over allotment option, in which it received additional proceeds of $72.9 million (net of offering expenses). Much of the language in the Registration Statement and Prospectus for the notes offering was similar to that contained in the Prospectus for Exodus' secondary public offering. In the Registration Statement and Prospectus for the notes offering, ***Exodus also represented that the GlobalCenter acquisition would enhance the Company, that Exodus had a diverse base of customers and had strong demand from the enterprise market, and that Exodus achieved certain financial results in fourth quarter and fiscal 2000***. The Prospectus also falsely claimed that Exodus had 4,500 customers under contract that it was serving.

60. The foregoing statements contained in the Prospectuses for Exodus' secondary public offering and notes offering were false and misleading. As set forth below in ¶¶105-129, 152-191, defendants were aware the Company's financial results were false due to improper revenue recognition practices and failure to conform with GAAP. Defendants were also aware, as set forth below in ¶¶145-147, that Exodus' internal due diligence team recommended against the GlobalCenter acquisition. As set forth below, defendants were aware that the Company was not seeing strong demand from the enterprise market. Additionally, as set forth below in ¶¶129-130, defendants were aware that there were revenue recognition issues with respect to some of Exodus' "representative customers." Further, in February 2001, Exodus' Solomon database only reflected 3,500 customers and of those customers, over 1,000 more were not active and had cancelled according to CW12.

61. On March 30, 2001, Exodus filed its Form 10-K with the SEC for its fiscal year 2000 ending December 31, 2000, signed by CEO Hancock, CFO Case and members of Exodus' Board of Directors. In the Form 10-K, with regards to the GlobalCenter acquisition, defendants represented that "***[w]e believe that the acquisition [of GlobalCenter on January 10, 2001] enhances our global Internet Data Center infrastructure***, strengthens our network, our customer support, sales and professional services organizations, and expands our customer base."

62. In the Form 10-K, defendants also represented: "We have established a diverse base of customers and continue to focus on supporting the ***strong demand from large enterprise customers***." Defendants further provided a list of representative customers, including ***iBeam Broadcasting Corporation, Inktomi and Storagenetworks***. According to the Form 10-K, none of Exodus' customers individually represented in excess of 10% of its revenues in 2000.

63. The Form 10-K also indicated that Exodus achieved the following financial results for fiscal 2000:

Cash and cash equivalents	$805 million
Accounts receivable	$175 million
Revenues	$818 million

The Form 10-K also stated, with regards to recognition of revenue, that:

> We adopted Staff Accounting Bulletin No. 101 ("SAB 101"), Revenue Recognition in Financial Statements, during our fourth fiscal quarter effective January 1, 2000. SAB 101 identifies the following four essential criteria that must be met before revenue can be recognized:
>
> - ***Persuasive evidence of an arrangement exists;***
> - ***Delivery has occurred or services have been rendered;***
> - ***The fee for the arrangement is fixed or determinable; and***
> - ***Collectibility is reasonably assured.***
> - Persuasive Evidence of an Arrangement.
>
> We document all terms of an arrangement in a written contract signed by the customer prior to recognizing revenue.
>
> Delivery Has Occurred or Services have been Performed
>
> ***We perform all services or deliver all products prior to recognizing revenue***. Monthly services are considered to be performed ratably over the term of the arrangement. Professional consulting services are considered to be performed when the services are complete. Equipment is considered delivered upon delivery to a customer's designated location.
>
> The Fee for the Arrangement is Fixed or Determinable
>
> A customer's fee is either fixed or determinable under the terms of the written contract prior to recognizing revenue. Fees for most monthly service, professional consulting services, equipment sales and rentals are fixed under the terms of the written contract. Fees for certain monthly services, including certain portions of networking, storage, and content distribution and caching services, are variable based on an objectively determinable factor such as usage. Such factors are included in the written contract such that the customer's fee is determinable. The customer's fee is negotiated at the outset of the arrangement and is not subject to refund or subject to adjustment during the initial term of the arrangement.
>
> Collectibility is Reasonably Assured

We determine that collectibility is reasonably assured prior to recognizing revenue. Collectibility is assessed on a customer by customer basis based on criteria outlined by management. New customers are subject to a credit review process, which evaluates the customers' financial position and ultimately their ability to pay. We do not enter into arrangements unless collectibility is reasonably assured at the outset. Existing customers are subject to ongoing credit evaluations based on payment history and other factors. If it is determined during the arrangement that collectibility is not reasonably assured, revenue is recognized on a cash basis.

Multiple-Element Arrangements

We enter into multiple-element arrangements, which may include any combination of monthly IDC services, professional consulting services or equipment sales or rentals. Each element of a multiple-element arrangement is evaluated to determine whether it represents a separate earnings process. In determining whether an element is a separate earnings process, we consider all applicable facts and circumstances including whether we sell or could readily sell the element unaccompanied by other elements. If a multiple-element arrangement can be segmented, revenue is allocated among the multiple-elements based on the fair value of the elements. If an undelivered element is essential to the functionality of a delivered element, no revenue allocated to the delivered element is recognized until that undelivered element is delivered.

Revenue recognition for segmented elements of a multiple element arrangement or for separate sales of our product and services offerings is as follows:

Fees for Monthly Internet Data Center Services and Related Installation Services

We have determined that monthly IDC services represent a separate earnings process because we regularly sell these services unaccompanied by other elements. Revenue is allocated to monthly services based on reliable verifiable and objectively determinable fair value, which is based on fees received when comparable services are sold separately. Revenue from fixed monthly IDC services is recognized ratably over the contract term, generally one year. Revenue from variable monthly IDC services are recognized as the change in factors on which the variable fees are based occurs.

We have determined that installation services related to monthly services do not represent a separate earnings process. Therefore, revenue from such installation services are deferred and recognized over the contractual term of the arrangement. Incremental direct costs of such installations are deferred and amortized over the contractual term of the arrangement.

Prior to the adoption of SAB 101, we recognized revenue for installation services upon completion of the services and the associated costs as incurred. The cumulative effect of the change in accounting for installation services and incremental direct costs of these services on all prior years resulted in an $8.4 million increase in net loss for the year ended December 31, 2000, and is reflected as the cumulative effect of change in accounting principle. Revenue for the year ended December 31, 2000 includes $8.8 million that was included in the cumulative effect adjustment.

Fees for Professional Consulting Services

We have determined that professional consulting services represent a separate earnings process based on the following factors: (i) the services are not essential to the functionality of other elements of the arrangements, (ii) the services can and have been sold separately both to existing Exodus IDC customers and non-Exodus IDC customers, and (iii) similar services can and have been performed by the customer or other vendors. Revenue is allocated to professional consulting services based on reliable, verifiable and objectively determinable fair value, which is based on fees received when comparable services are sold separately. Revenue from professional consulting services is recognized when the services are complete.

Fees from the Sale or Rental of Equipment and other products

We have determined that the sale or rental of equipment and other products represents a separate earnings process based on the following factors: (i) the equipment and other products can and have been sold or rented separately, (ii) the equipment and other products can be purchased from other vendors, and (iii) the functionality of the equipment and other products is not affected by any undelivered element. Revenue is allocated to equipment sale or rental based on reliable, verifiable and objectively determinable fair value, which is based on fees received when comparable equipment and other products are sold or rented separately.

Revenue from the sale of equipment and other products and from sales type leases is recognized upon delivery to the customer's designated location. Fees from operating leases are recognized on a straight-line basis over the lease term. Revenue from the sale or rental of equipment and other products was less than 10% of consolidated revenue in each of the years in the three-year period ended December 31, 2000.

64. With respect to the Company's revenue, the Form 10-K also stated:

Our revenues increased 238% to $818.4 million in 2000 from $242.1 million in 1999, and increased 359% in 1999 from $52.7 million in 1998. The revenue growth reflects increases in hosting, network services and managed services, as a result of increases in new customers, increases in orders from existing customers as well as new revenues arising from our managed services group, including storage management and security services. Revenues directly attributable to IDC's increased to $695.7 million in 2000 from $199.6 million in 1999, an increase of 249%. IDC revenue increased 282% from $199.6 million in 1999 as compared with $52.3 million in 1998. We opened 11 new IDCs during 2000 for a total of 30 at year end. Effective at the closing of the GlobalCenter acquisition on January 10, 2001, we added an additional 10 IDCs. Operating IDCs were 19 and 8 at the end of 1999 and 1998, respectively. At December 31, 2000, we served approximately 4,000 IDC customers compared to approximately 2,300 at December 31, 1999 and 1,000 at December 31, 1998. Professional services revenue increased 188% in 2000 to $122.8 million from $42.6 million in 1999 and increased 8,733% in 1999 from $482,000 in 1998. The increase from 1999 to 2000 relates to increased demand for our professional service offerings and from 1998 to 1999 from increased demand as well as our acquisition of Cohesive Technology Solutions, Inc. in July 1999. ***We expect our revenues to increase in 2001 from their levels in 2000 as we continue to book new annualized recurring revenue from both***

> ***new and existing customers, increase the number of operating IDCs, and receive revenues from customers acquired in the acquisition of GlobalCenter, which closed on January 10, 2001***.

The 10-K also included an audit report by KPMG dated January 24, 2001, which stated:

> ***In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Exodus Communications, Inc. and subsidiaries as of December 31, 2000 and 1999***, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2000, ***in conformity with accounting principles generally accepted in the United States of America***. Also, in our opinion, ***the related financial statement schedule, when considered in relation to the consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein***.

65. Soon after filing its Form 10-K, Exodus distributed its Annual Report to Shareholders for fiscal year 2000. The Annual Report contained a copy of the Company's Form 10-K. It also contained a letter to shareholders signed by Hancock, which stated that "***[w]e believe we are well positioned ... as customers, technology and even trends demand the proven, market-leading expertise that Exodus has continually demonstrated***."

66. The foregoing statements contained in Exodus' Form 10-K and Annual Report were false and misleading when made. As set forth below in ¶¶105-129, 152-191, defendants were aware that Exodus' financial results were false due to improper revenue recognition practices and that the Company failed to conform with GAAP. Further, as set forth below in ¶¶145-147, defendants were aware that the Company's internal due diligence team recommended against the GlobalCenter acquisition. Additionally, as set forth below, contrary to defendants' representation, they were aware that Exodus was not experiencing strong demand from enterprise customers. Moreover, as set forth below in ¶¶129-130, defendants were aware Exodus had revenue recognition issues with respect to some of its "representative customers." Defendants also misrepresented the number of customers by including customers who were not active, who had cancelled and who had no ability to pay.

67. On April 26, 2001, Exodus announced its first quarter 2001 results via the *BusinessWire*. According to the Company's press release, ***Exodus achieved first quarter 2001 revenues of $348.7 million, EBITDA profit of $5.5 million for the first quarter 2001, and net loss for the first quarter of $649.6 million or $1.21 per share***. In the press release, defendants highlighted the strength of the Company and indicated that it was doing well despite the economic slowdown and the dot-com fallout. Defendants represented that among the "key milestones" the Company achieved during the quarter were:

> • The Company began the quarter with approximately ***4,000 IDC customers***. During the quarter, it won a number of new customers, acquired many more through the GlobalCenter acquisition, and churned out others. ***This resulted in a much stronger base of 4,526 IDC customers at the end of the quarter***....
>
> • ***At quarter end, enterprise customers represented 62 percent of Exodus's total monthly recurring revenues and bookings, compared to 44 percent one year ago as the Company continues to shift its customer base to enterprises***.

* * *

"***Exodus' business continues to grow, due primarily to its strong business model and customer relationships," said Ellen M. Hancock, chairman and CEO***. "***We are benefiting from a 'flight to quality' as businesses seek to outsource their key operations to experienced, established providers like Exodus. We believe we have reduced our exposure to the dot com slowdown during the quarter by targeting and winning enterprise customers, and the changes in our customer mix during the quarter provide us with an even stronger customer base to build on***. We are pleased that we were able to deliver on our bottom line, even in the challenging current economic environment," said Hancock. "Exodus remains focused on delivering the highest quality service and strengthening customer and partner relationships."

* * *

Exodus expects to achieve second quarter 2001 results as follows:

• ***Revenue of approximately $360 million***
• ***Gross margins of approximately 27 percent of revenue***
• ***EBITDA of at least $25 million*** ...
• ***Cash net loss of approximately $110 million to $115 million, or $0.19 to $0.20 per share***
...

Exodus expects results for 2001 as follows:

• ***Revenues of approximately $1.5 billion to $1.6 billion***
• ***Gross margins of approximately 31%*** to 33% of revenue
• ***EBITDA of at least $270 million*** ...
• ***Cash net loss of approximately $300 million to $320 million*** ...

* * *

> "***With over $1 billion in cash, the Company is fully funded to achieve its current business plan and we do not anticipate returning to the debt or equity markets for additional capital to meet our plan***," said Hancock. "***We are and believe we will continue to be in compliance with the covenants of our bank credit facility, under which we currently have borrowings of $150 million***."

> "We believe the hosting market will continue to grow as more and more companies realize the operating efficiencies and cost savings that can be obtained through utilisation of the Internet and outsourcing. While businesses will continue to use the Internet for business-to-consumer applications, we believe there will be increased growth from business-to-business and business-to-employee applications. ***The offerings and services that Exodus provides, and our well-trained sales teams, make Exodus today uniquely positioned to take advantage of the changing business landscape. We are confident that Exodus is in a sound position to successfully manage through***

> ***the current fluctuations in the economy and in our industry***," concluded Hancock.

68. On April 26, 2001, Exodus also held a conference call with securities analysts and investors to discuss its first quarter 2001 results. On the conference call, CEO Hancock represented that the Company had a strong customer base by stating:

> We began the quarter with approximately ***4,000 customers***. During the quarter, we won a number of new customers, acquired many more through the Global Center acquisition and churned others. This resulted in ***a much stronger customer base of 4,526 customers at the end of the quarter***....

On the conference call, Hancock also represented that Exodus was doing well despite the economic slowdown. Hancock stated that "***despite the economic slowdown, Exodus was able to leverage its focus on enterprise customers and its market leadership position to continue to grow revenues and push profitability***"; that "***Exodus is in a sound position to successfully manage through the current fluctuations in the economy and in our industry***"; and that "***we are well positioned for the remainder of 2001 and beyond***." As stated by Hancock:

> We are managing within the current economic environment carefully, and we are confident that ***Exodus is well positioned for continued growth and future profitability***. Now the future and its silver lining of the market slowdown is that Exodus's competitive position will likely get even stronger for several reasons. First, as a result of having targeted enterprises in the last several years, we believe ***we have reduced our exposure to the dot com slowdown***. Approximately two-thirds of all new bookings in Q1 came from enterprise customers. Second, the current economic environment has been accelerating the flight to quality. ***Businesses want to outsource their operations to experienced, established hosting providers like Exodus***.... Third, we have a clear path to profitability.... We currently expect to turn ***cash EPS positive during the first half of 2002***. And fourth, ***we have a fully funded business plan***. We have $1.1 billion in cash and cash equivalents at the end of the quarter, and with our emphasis on improving bottom line performance, we are comfortable that this will be enough to fuel our growth. Unlike many hosting Internet infrastructure companies that are not fully funded, we are not dependent upon a quick market rebound to provide additional financing.

During the conference call, Case, the Company's CFO, also stated that Exodus was immune to the economic environment in part because the Company was gaining enterprise customers. As Case stated:

> Once again, ***we continue to execute our strategy to pursue and win additional enterprise customers, reducing our exposure to the dot-com slowdown***. Enterprise customers represented 62% of our total revenue and bookings as of end of the first quarter compared to 57% in the prior quarter and only 44% in the first quarter of 2000.

Similarly, Hancock represented: "***We continue to win large and enterprise customers*** based on the strength of our balance sheet, the quality of our services, our leadership position in the industry and the flexibility that we provide to our customers."

69. CFO Case also provided financial guidance for second quarter 2001 and fiscal 2001. According to Case, the Company expected to achieve ***in second quarater 2001 $360 million in revenues, gross***

margin of 27% of revenues, EBITDA of at least $25-$30 million, and cash net loss of $110-$115 million, or $0.19 to $0.20 per share. With regards to fiscal 2001, Case stated that the Company expected to achieve ***$1.5-$1.6 billion in revenues, gross margin of 31%-33%, EBITDA of at least $270 million, and cash net loss of $300-$325 million***. Case also stated that "the Company anticipates that ***it will turn positive during the first half of 2002***." With regard to the Company's financial guidance, Case stated that the figures provided were "***conservative***." Further, Case indicated that, even though Exodus experienced annual customer ***churn of 6% in the first quarter***, and the Company's forecast assumes that it will experience churn in the second quarter comparable to the first quarter, "***we believe that this level of churn will not significantly hinder our ability to deliver on the revenue targets***." Moreover, while Case acknowledged that there are uncertainties in the economic environment, he asserted that "***we are opening IDC's to meet known customer demands***." With regard to Exodus' loan covenants, both Hancock and Case emphasized that the Company would not fall out of compliance with the covenants. According to Case: "We are currently in compliance with the covenants of our bank credit facility under which we have borrowed approximately $150 million and we believe ***we will continue to be in compliance***." Further, according to Hancock:

> We anticipate that ***the guidance we just gave you for Q2 supports the debt covenant. We believe that the guidance we give you for the full year covers the debt covenants, and I can only say this five times more, we are okay on the debt covenants, Q1, Q2, Q3, Q4***, assuming that our guidance is correct.

Additionally, during the question and answer segment of the conference call, in response to an analyst's question, Hancock indicated that Exodus was actually increasing its prices despite price discounting from competitors. Hancock stated:

> ***In terms of pricing, we, as you know, announced a price increase in the area of our infrastructure as well as many of our managed professional services*** ....

Further, with regards to the Company's business plan, Hancock stated that "***we are still confident that we should be able to turn cash EPS positive in the first half of, of next year***."

70. On the evening of April 26, 2001, Exodus CEO Hancock was interviewed by reporter Willow Bay on CNN's Moneyline, broadcast at 6:30 p.m. EST. During the interview, Hancock stated that Exodus was "***seeing increased demand from enterprise customers***." She also stated: "[***W]e are going to close to double our revenue this year over last year. So we're still seeing growth. We're being conservative in this next quarter***...."

71. The foregoing oral and written statements made on April 26, 2001 were false and misleading when made. As set forth below in ¶¶105-129, 152-191, the Company's financial results were false due to improper revenue recognition practices and failure to conform with GAAP. Further, as set forth below in ¶¶129-130, the Company's cash balances were inaccurate. Additionally, as set forth below in ¶¶148-150, defendants were aware that the Company was not fully funded to achieve its business plan. Moreover, as set forth below in ¶¶133-141, defendants were well aware that the Company did not have a strong customer base as it was suffering from high rates of cancellation, bankruptcy and delinquency from customers, was suffering from extraordinary rates of bad debt, and was not seeing increased demand. As set forth, defendants were also aware Exodus' IDCs were operating under capacity. Defendants were aware that due to the Company's poor business condition, Exodus would have to repay the Company's $150 loan from Chase Manhattan to prevent running afoul of its loan covenants. Defendants were aware that their forecasts were overly aggressive and made without reasonable basis. Defendants also

misrepresented the number of customers by including customers who were not active, who had cancelled and who had no ability to pay.

72. On April 30, 2001, Exodus issued a press release via the *BusinessWire* announcing the departure of Case, the Company's CFO, for personal reasons. It announced that Stoltz, who had previously served as Exodus' CEO, would take over the day-to-day financial management of Exodus while a search was conducted for Case's replacement. Additionally, although Exodus did not specifically issue an announcement, Exodus' President and Chief Operating Officer, Casey, and Executive Vice President and head of marketing, Beverly Brown, also departed the Company.

73. On May 1, 2001, Exodus issued a press release via the *BusinessWire* headlined "Exodus Announces Conference Call to Reaffirm Guidance and Clarify Organizational Changes." In the conference call held later that day, defendant Hancock reassured financial analysts that the recent management change would benefit Exodus by giving Exodus "a solid executive team and a streamlined organization." Further, defendant Stoltz reassured analysts that "***Marshall [Case]'s departure is in no way related to our Q1 results or guidance [for Q2 and fiscal 2001]***." With respect to Exodus' business condition and outlook, Hancock stated that, "***[w]e believe that we have a market leading position, an achievable and fully funded business plan, and solid long term demand for our services***." Defendant Stoltz ***reaffirmed the Company's guidance for second quarter 2001*** of revenue of approximately $360 million; gross margin of approximately 27%; EBITDA of at least $25 million; and cash net loss of $110-$115 million, or $0.19 to $0.20 per share. Stoltz also ***reaffirmed fiscal 2001 guidance*** of revenues of approximate $1.5-$1.6 billion, "which is approximately double our prior years' total," gross margins of 31%-33% of revenue, EBITDA of at least $270 million, and cash net loss of $300-$320 million. Stoltz also stated that "the company anticipates that ***we will turn positive during the first half of 2002***." Further, Stoltz stated: "***[T]o be honest, there are some analysts out there that think that we are very aggressive on such a positive EBITDA.... And I have gone through the plan and you know I feel comfortable that those numbers are achievable***...."

74. On May 9, 2001, Exodus issued a press release via the *BusinessWire* regarding its cost cutting measures which defendants represented would help the Company achieve its financial plan. According to the press release:

> "We have been analyzing all aspects of our operations," said Dick Stoltz, Exodus' chief financial officer. "***We believe we can achieve our financial plan*** by reorganizing and strengthening our operations. These staff reductions are consistent with that goal. As a result, we expect to record a non-recurring charge of less than $10 million for the current quarter."
>
> "The streamlining we're doing does not affect our ability to serve our current customers or our ability to attract and serve new customers with the high quality of service and security customers have come to expect from Exodus," Stoltz said. "***We continue to expand our footprint of operations. We opened Internet data centers in Dallas and Amsterdam last month, and next week we will open an Internet data center in Paris***. Our goal with these efforts is to ensure we have the right people in the right places. ***We believe these actions will strengthen our competitive position in the marketplace***."

75. The foregoing statements were false and misleading when made. As set forth below in ¶¶148-150, defendants were aware that the Company was not fully funded to achieve its business plan. Further, as set forth below in ¶¶131-132, defendants were aware that their forecasts were overly aggressive and made

without reasonable basis.

76. On May 15, 2001, Exodus filed its Form 10-Q with the SEC for the quarterly period ended March 31, 2001, signed by defendant Stoltz. The 10-Q showed that Exodus had achieved the following financial results:

Cash and cash equivalents	$1.04 billion
Accounts receivable	$238 million
Revenues	$438 million

The Form 10-Q stated, with regards to its financial statements, that:

> The accompanying unaudited condensed consolidated financial statements ***have been prepared in accordance with generally accepted accounting principles*** for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not contain all of the information and footnotes required by generally accounting principles for complete financial statements. ***In the opinion of management, the accompanying unaudited condensed consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of the Company's financial position as of March 31, 2001 and December 31, 2000, and the results of its operations and cash flows for the three-month periods ended March 31, 2001 and 2002***.

The Form 10-Q also stated, with regards to revenues, that:

> Service revenue increased to $300.2 million for the three-month period ended March 31, 2001 from $244.7 and $124.3 million for the three-month periods ended December 31, 2000 and March 31, 2000, respectively, increases of 23% and 141%. The revenue growth reflects increases in hosting, network services and managed services, as a result of increases in new customers, orders for additional services from existing customers, increased traffic as well as new revenue arising from our managed service group, including storage management, security services, content distribution, managed hosting and web application management....
>
> Professional service revenue was $32.3 million for the three months ended March 31, 2001, compared with $32.9 million and $24.3 million for the three months ended December 31, 2000 and March 31, 2000, respectively....
>
> ***We expect our revenue to increase, as a result of expansion of our customer base and increased sales to existing customers***. This increase will be offset in part by customers going out of business or downsizing or terminating their Internet operations due to a variety of factors including the current economic environment.
>
> Other Revenue
>
> Other revenue increased to $48.4 million for the three-month period ended March 31, 2001 from $8.1 million in the same period of the prior year, an increase of 496%.

The 10-Q further indicated that its IDCs were full, by stating: "We intend to continue to expand our network of Internet Data Centers domestically and internationally to ***meet the demand for our services***."

77. The foregoing statements were false and misleading when made. As set forth below in ¶¶105-129, 152-191, defendants were aware Exodus' financial results were false due to improper revenue recognition practices. Further, as set forth below in ¶¶105-129, 152-191, contrary to defendants' representation, Exodus' financial results did not conform with GAAP. Additionally, as set forth below in ¶¶133-132, contrary to defendants' representations that demand was increasing, defendants were aware that demand was weak.

78. By this time, the problems affecting Internet web hosters were starting to trickle into the public. Nevertheless, Exodus continued to deny that it had problems. For example, a June 18, 2001 *Wall Street Journal* article reported that even though certain analysts believe there is a glut in data center space, Exodus claimed that it was insulated from the data center glut. The article stated in part, as follows:

> According to Ted Chamberlain, an analyst at Gartner, Inc., "there's a glut of data-center space." Analyst Stephen Murphy Murphy of CIBC World Markets estimated in a report in early June that only 22% of all the data center space available in North America this year will be used or sold to customers, leaving about 78% unsold. Gartner predicts that demand for data-center space, also known as co-location space, will grow by 2% to 5% annually over the next four years (down from previous forecasts of 25% to 35%). PSINet and Colo.com, both of which provide Web-hosting services, have already filed for bankruptcy protection. However, ***Web-hosting companies like Exodus argue that they're insulated from data-center glut because they have diversified business beyond providing floor space, getting a substantial portion of revenue from computer management services. Hancock said 65% of the company's customers buy other services from Exodus other than just co-location, and that percentage is going up. In fact, Exodus opened 3 data centers in Dallas, Paris and Amsterdam in recent weeks and has raised its prices, she said***. However, Garner's Chamberlain says Exodus has data centers that it has essentially "mothballed" or hasn't opened, which could be considered excess capacity. Also, according to UBS Warburg analyst John Hodulik, because Exodus sells its hosting services as a package, it might be difficult to tell if it was discounting prices for co-location and connectivity but boosting prices for services.

79. On June 20, 2001, Exodus preannounced its second quarter 2001 results, which fell far short of management's guidance to analysts and the public. Exodus' press release disclosed that it would suffer disastrous second quarter 2001 results and that it was drastically reducing its guidance for the remainder of fiscal 2001. The press release stated:

> ***Revenue growth for the quarter and year will be below the company's previous expectations. The company now expects revenues in the second quarter of 2001 to be approximately $315 million*** compared to first quarter 2001 revenues of $348.7 million. ***The revenue shortfall is due to a decrease in the rate of new customer installations, an increase in the rate of cancellations, reduction of orders from existing customers, and an increase in reserves related to dot com failures***. ***The company now expects second quarter gross margins to be approximately 21 percent and EBITDA to be slightly negative*** compared to $5.5 million for the first quarter, excluding a restructuring charge of up to $25 million. ***Cash net loss for the second quarter is expected to be approximately $140 million*** compared to $118.3 million for the first quarter. The company expects new bookings from customers to be approximately in line with last quarter's level of $200 million.

The company expects revenue for the full year will be approximately $1.35 billion and expects gross margins to be approximately 23 percent. Full year 2001 EBITDA is expected to be approximately $80 million. Full year cash net loss is expected to be approximately $500 million.

"While market conditions are certainly more challenging than they were a few months ago, ***we remain optimistic about the overall market and Exodus' position***," said Exodus Chairman and CEO Ellen Hancock. "The fundamentals underlying managed hosting are solid. Enterprises continue to look at the web as a way to reduce costs, enhance communications with their customers, partners and employees and as a way to enhance productivity. We are the recognized market leader in managed hosting services," she said.

Credit Facility

The company is announcing today that it has decided to repay the $150 million loan under its senior credit facility. By doing so, the company will be able to operate without the restrictions imposed by the facility. With this repayment and the cost containment actions the company is taking, Exodus expects that it is fully funded through the period it reaches free cash flow positive, expected for the third quarter of 2002. By eliminating the credit facility, the company is able to use its assets with greater flexibility to obtain additional financing if it so chooses. Exodus believes that if available, such asset based financing could provide in excess of $500 million of additional funding for the company.

Cost Reductions and Liquidity

* * *

The company expects to end the second quarter of 2001 with approximately $550 million in cash, and exit the year with approximately $200 million after repayment of the credit facility assuming no additional financing.

80. Following Exodus' disclosure of some of the adverse conditions then affecting the Company, its stock dropped almost 50% to as low as $1.18 the next day on high volume of 186,361,300 shares. During the Class Period, Exodus stock traded as high as $179 per share.

81. Within days thereafter, analysts quickly downgraded the stock, including Salomon Smith Barney, which downgraded Exodus to "neutral" from "buy" and removed it from its "U.S. recommended-for-purchase list"; Goldman Sachs, which downgraded the stock to "market perform" and taking it off Goldman's "recommended-list"; UBS Warburg, which cut its price target to $3 per share from $15; Lehman, which downgraded Exodus from "buy" to "market perform"; and Morgan Stanley Dean Witter, which downgraded the stock from "strong buy" to "neutral." Moreover, Jeff Camp, an analyst with Morgan Stanley Dean Witter, took the rare step of apologizing for not downgrading Exodus earlier. According to Jeff Camp, "***The retail buyers, I would say, the individual investors, you know, the people that we see every day are angry***. And there is no question about it. ***They have a right to be angry*** and that's where the apology came from."

82. With respect to Exodus' bonds, S&P cut Exodus' bond rating to "B-" and its convertible bonds to junk status at "CCC." Similarly, Moody's downgraded Exodus' senior unsecured debt from B3 to Caa1.

83. Further, several financial articles indicated that Wall Street had been misled by the Company. For example, an article dated June 21, 2001 by Michael Liedtke on ***AP Online*** stated:

> Shares of Exodus Communications Inc. plunged 30 percent Thursday after the Web hosting service delivered a rude financial surprise that amplified concerns about the once-vibrant company's ability to survive the dot-com meltdown.
>
> Shares in the Santa Clara-based company fell 68 cents to close at $1.57 Thursday on the Nasdaq Stock Market. The selloff continued an investor retreat that has left Exodus' stock a fraction of its 52-week high of $69.
>
> ***Thursday's backlash reflects a spreading sentiment that Exodus has been misleading Wall Street about its business outlook, said analyst Frederick Moran of Jeffries & Co. in New York***.
>
> "***You can only pull the wool over the eyes of Wall Streeters so many times before they throw in the towel on you," Moran said. "Investors have given up on Exodus. It's obviously not funded to last beyond this year***."
>
> * * *
>
> ***Investors are losing their patience with Exodus because management has previously issued reassuring statements only to change its tune later, said analyst James Linnehan of Thomas Weisel Partners***.
>
> "***How much confidence can we have in them this time? They are losing their credibility with the market," Linnehan said. "This could be a death watch now***."

Similarly, a June 21, 2001 analyst report written by Daniel J. Renouard of Robert W. Baird & Co. regarding Exodus emphasized: "***Management Credibility Shaky***."

84. Even though Exodus' announcement on June 20, 2001 revealed some of the negative conditions that had been impacting the Company, it did not reveal the entire fraud, causing its stock price to continue trading at artificially inflated levels. Further, subsequent to the June 20, 2001 announcement, defendants continued to deny problems facing Exodus, and continued to make false and misleading statements.

85. On July 6, 2001, Exodus filed a Form S-8 Registration Statement with the SEC in connection with the registration of shares reserved for issuance upon exercise of stock options under the Company's 1998 Equity Incentive Plan. In connection with the Registration Statement, KPMG consented to the incorporation by reference of its audit report dated January 24, 2001, which was false for certifying that the Company had fairly represented its financial condition.

86. On July 16, 2001, Exodus issued a press release announcing that William Austin was named the Company's CFO, and that Richard Stoltz, the interim and previous Chief Financial Officer and Chief Operating Officer, assumed the position of Senior Advisor of Strategy and Finance to the CEO.

87. On July 26, 2001, Exodus issued a press release announcing its second quarter 2001 results. The press release continued to portray Exodus as a market leader continuing to increase its strength and on the clear path to profitability. According to the press release:

> ***Exodus Communications, Inc. (NASDAQ: EXDS) today reported second quarter 2001 revenues of $318.7 million, above the most recent guidance. This revenue compares to $177.7 million in the second quarter 2000, an increase of 79 percent***.
>
> EBITDA profit was $3.2 million for the second quarter 2001, also above the most recent guidance, compared to $8.1 million for the second quarter 2000, marking the sixth consecutive quarter the Company has delivered positive EBITDA results (excluding the impact of SAB101).
>
> Cash net loss was $138.5 million for the second quarter 2001, or $0.25 per share, compared with a cash net loss of $43.0 million, or $0.11 per share, for the second quarter 2000. Cash and cash equivalents were $616.8 million at the end of the quarter.
>
> During the second quarter, the Company recorded total charges of $318.3 million for restructuring and related activities, primarily from the disposition of certain excess administrative and non-operational facilities, and, to a less extent, staff reductions and the impairment of other assets. These activities, combined with other cost reduction activities, are expected to result in reduced spending of over $250 million annually.
>
> Net loss for the second quarter 2001 was $583.4 million or $1.05 per share, compared to $51.8 million or $0.13 per share in the second quarter 2000.
>
> "Exodus has delivered a solid quarter in a challenging environment," said Ellen M. Hancock, chairman and CEO of Exodus. "Exodus continues to attract and sign new customers and expand the services provided to existing customers. We are pleased to add 264 new names to our long list of customers who outsource their operations to Exodus. ***Although we continue to see churn, we have been replacing those customers with new ones that make our customer base even stronger***. The vast majority of our customer churn was the result of the general economic environment and the financial pressures those customers experienced. No other company can provide what we do in terms of the quality and depth of service offerings and customer support. Our global network and outsourcing solutions are unsurpassed. The Company's outstanding customer and partner relationships and our dedicated and skilled employees are the key to industry leadership."
>
> "In response to the current economic environment, we have implemented plans to reduce our expenditures and strengthen our business," said Hancock. "***We continue to target the third quarter of next year to achieve free cash flow***."
>
> Key milestones and metrics that the Company achieved during the quarter include:
>
> • ***Signing over $200 million of gross new annualized recurring bookings for the quarter. Assuming these bookings were installed today, the $200 million represents the recurring revenues that would result from these new contracts over the next 12 months. In addition to the gross new bookings, we received orders for non-recurring revenues from equipment sales, consulting services and other services***.

• ***The net number of outsourcing customers increased to 4,540 at quarter end***.

* * *

• At quarter end, enterprise customers increased to 63 percent of Exodus' total monthly recurring revenues and bookings, compared to 45 percent one year ago. This achievement demonstrates the progress the Company has made in shifting its customer mix toward an enterprise customer base.

• ***The annualized recurring revenue run rate at the end of the quarter was approximately $1.44 billion***.

• Average annualized revenue per IDC customer was approximately $317,000.

• ***In response to new outsourcing demand, the Company opened IDCs*** in Amsterdam, Dallas, Miami and Paris. At quarter end, total gross square footage grew to approximately 5.6 million square feet in 44 IDCs.

• The GlobalCenter(R) acquisition is essentially complete and all significant functions and operations are now fully integrated.

Second Quarter Highlights

Operational and financial highlights for the second quarter are as follows:

• Total revenue mix consisted of:
48 percent from infrastructure
31 percent from managed and professional services
21 percent from Internet connectivity
• Gross margins, excluding restructuring and asset impairment charges, were:
23 percent of revenue, or $74.7 million
43 percent of revenue, or $137.8 million, excluding depreciation and amortization
• ***Annualized churn was 9 percent at quarter end***
• The number of EBITDA positive IDCs remained at 27
• ***Days sales outstanding were 72 days***
• Capital expenditures were $188.6 million and principally represented investments to build and expand IDCs

* * *

Exodus expects to achieve third quarter 2001 results as follows:

• ***Revenue of approximately $325 million***
• Gross margins of approximately 22 percent of revenue
• EBITDA of approximately $15-$20 million
• Cash net loss of approximately $145 million, or $0.26 per share
• Exodus expects results for 2001 as follows:
• Revenues of approximately $1.35 billion

• Gross margins of approximately 23 percent of revenue
• EBITDA of approximately $70-$80 million
• Cash net loss of approximately $515 million, or $0.93 per share
• Gross IDC square footage will be 5.9 million after opening additional IDCs in the Santa Clara and Washington, DC areas
• Capital expenditures of approximately $900 million
• ***Cash and cash equivalents exiting the year of approximately $200 million***

> "As businesses continue to grow and expand their e-commerce and Internet initiatives, outsourcing remains a critical component of those strategies," said Hancock. "***Exodus is well positioned*** with the capacity and the value added service offerings to take advantage of this growth. Utilizing a partner like Exodus is the best way for companies to implement their mission-critical outsourcing initiatives."

88. The foregoing statements were false and misleading because, as set forth below in ¶¶105-129, 152-191, Exodus' financial results were false due to improper revenue recognition practices and failure to conform with GAAP. Further, as set forth below in ¶¶192, Exodus' cash balances were also false. Defendants also misrepresented the number of customers by including customers who were not active, who had cancelled and who had no ability to pay.

89. On August 2, 2001, Cnet News.com published an interview with Hancock. In the interview, Hancock continued to dispel rumors of problems with Exodus:

Q: Why do you think Exodus stock has been popular with short sellers?

A: I believe we had a series of disconnects about our business with some analysts. ***One was whether there's a glut of data centers. Absolutely not true. We opened up four new data centers in the quarter. We expect to open a new data center on the East Coast this quarter and it looks like we'll need to open another data center on the West Coast this year. So we don't believe in the glut theory***. Second, the theory goes, is that because of a glut, we're doing massive discounting. And we say, 'Sorry, we're not doing that.' And then there was the comment that 'They're not going to have enough cash, because if they spend this much in the first half, they must be going to spend that much in the second half.' And the answer is, we're not. So we did have some disconnects with the analysts, and I believe that did have an impact on how people feel about the stock.

90. On August 14, 2001, Exodus filed its Form 10-Q for the quarterly period ending June 30, 2001, signed by William Austin, as follows:

Cash and cash equivalents	$616 million
Accounts receivable	$272 million
Revenues	$282 million

The Form 10-Q stated, with regards to its financial statements, that:

> The accompanying unaudited condensed consolidated financial statements ***have been prepared in accordance with generally accepted accounting principles*** for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly,

> they do not contain all of the information and footnotes required by generally accounting principles for complete financial statements. ***In the opinion of management, the accompanying unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments, necessary for the fair presentation of the Company's financial position as of June 30, 2001 and the results of its operations and cash flows for the three and six-month periods ended June 30, 2001 and 2000***.

With regards to revenues, the Form 10-Q stated:

> Service revenue increased 75% and 104% to $282.5 million and $582.7 million for the three and six-month periods ended June 30, 2001 from $161.4 and $285.7 million for the same periods of the prior year, respectively.
>
> * * *
>
> Other revenue increased 122% and 246% to $36.2 million and $84.7 million for the three and six-month periods ended June 30, 2001 from $16.3 million and $24.4 million in the same periods of the prior year, respectively.

The Form 10-Q also stated:

> We believe our currently estimated working capital and capital expenditure requirements over the next 12 months can be met with existing cash and cash equivalents, cash from sales of services to customers and collections of existing and future accounts receivable from customers, cash from sales of investments and other property, existing and future lease financings and other financing lines of credit, and other debt or equity financings. We may also seek to raise additional funds through public or private debt or equity financings, strategic relationships or other arrangements.

In the Form 10-Q, the Company also disclosed that a member of its Board of Directors, Thadeus J. Mocarski, resigned from the Board and that the Board reduced the authorized number of members of the Board to nine.

91. On August 21, 2001, Exodus announced via a press release that two other Board members, Mark Dubovoy and Naomi Seligman, also resigned from the Board.

92. The departure of these three Board members was discussed in an article in the August 28, 2001 ***San Jose Mercury News***:

> Several venture capitalists theorized that the trio [Mocarski, Dubovoy and Seligman] hit the door in case the debt-saddled firm files for bankruptcy protection. The Securities and Exchange Commission used to require board members of public companies that go bankrupt to disclose that in future regulatory filings; those rules have changed, but not all VCs I spoke to knew that.
>
> None of the three ex-board members - venture capitalists Mark Dubovoy and Ted Mocarski, and e-commerce consultant Naomi Seligman - could be reached to comment. But ***Exodus Chief Executive Ellen Hancock says the company is in no danger of filing Chapter 11***.

> Hancock and Exodus board member Bill Krause say the defections were tied to the board members' need to move on to new investments, not Exodus' financial straits. Dobovoy and Mocarski came to the company via venture investments that were returned long ago to the limited partners in their respective firms.
>
> "They have no upside, and their limited partners put pressure on them to resign and manage new investments," says one valley insider, describing how such scenarios typically work.
>
> Hancock also shoots down published reports that the board members had quit following a heated debate about the Company's future. "To be blunt, that's bull," she says, adding a four-letter syllable to that word.

93. On August 27, 2001, *Information Week* reported Hancock saying that "***[w]e're viable ... [w]e have sufficient cash***," and that Exodus has sufficient cash to survive for another year, when she expects it to become cash-flow positive. Likewise, the September 3, 2001 *Computer Reseller News* article contained an interview with Hancock wherein Hancock was bullish about Exodus' future, asserted that Wall Street speculation that Exodus will be declaring bankruptcy within the next six months is wrong, and emphasized that Exodus will have enough money and does not need to get additional funding until it reaches profitability within about a year.

94. The next day, on September 4, 2001, Exodus announced that defendant Hancock resigned, and that William Krause was appointed as CEO and Chairman of the Board of the Company.

95. On September 25, 2001, the *Wall Street Journal* reported that people familiar with the situation said that Exodus was preparing a bankruptcy-court filing, and Exodus has been considering debtor-in-possession financing and other arrangements.

96. Following this leak regarding Exodus' bankruptcy, its stock price plummeted to 17 cents on record volume of 193 million shares.

97. The next day, on September 26, 2001, Exodus issued a press release announcing that it had filed for Chapter 11 bankruptcy. In the press release, new CEO Krause admitted that Exodus had excess capacity: "We sacrificed profitability in exchange for growth and market share, ***overexpanding in some areas in advance of demand***, not anticipating the decline as the dot.com bubble burst and the economy weakened."

98. Following the announcement of Exodus' bankruptcy, Nasdaq halted Exodus' trading until additional information was provided by the Company.

99. On October 5, 2001, when trading was allowed to resume on Exodus stock, Exodus' stock price dropped further to 10 cents on high volume of 72 million shares.

100. As a result, plaintiffs and members of the Class who acquired their Exodus shares during the Class Period suffered damages.

POST CLASS PERIOD EVENTS

101. On October 5, 2001, Exodus announced it had voluntarily delisted from the NASDAQ and began

trading on the OTC Bulletin Board.

102. Exodus has not reorganized but has liquidated. On June 5, 2002, the United States District Court for the District of Delaware confirmed Exodus' Second Amended Joint Plan of Reorganization. Under the Plan, all of the outstanding shares and all of the outstanding debt securities of Exodus were cancelled and ceased to be outstanding as of June 19, 2002.

103. Exodus' financial statements for fiscal 2001 were never audited because Exodus maintained, in a Form 12b-25 filing on April 2, 2002, that because it planned to liquidate, and that its common stock will have no value, such information would have little to no value or relevance to investors.

BASIS FOR THE ALLEGATIONS

104. The allegations herein are based on plaintiffs' counsels' investigation, including a review of publicly available documents, consisting of, *inter alia*, Exodus' filings with the SEC, Exodus' press releases, Exodus' conference calls, analyst reports on Exodus, and newspaper articles and other media coverage on Exodus and its officers. The allegations herein are also based upon certain Exodus internal documents and interviews with certain former Exodus employees including the following Confidential Witnesses ("CW"):

(a) **CW1** - CW1 was the Controller for Exodus' Professional Services Organization from January 2000 through February 2002. CW1 was responsible for the overall financial accounting and reporting for the Professional Services Organization, and is knowledgeable about Exodus' overall business and accounting operations because Professional Services interacted daily with the sales organization and had visibility over all of Exodus' revenue sources. CW1 was on distribution for all of Exodus' financial reporting, and regularly attended the Company's weekly executive staff meeting until the end of June 2001. These meetings were typically held on Monday mornings, and were attended by defendants Hancock, Case, Dollahite, Stoltz, Mohamad, Wegner, Yeack and Brown along with other officers. CW1 obtained an undergraduate degree in accounting and has passed the CPA exam.

(b) **CW2** - CW2 worked in public relations for Exodus until he was laid off in April 2001. In August 2001, CW2 was rehired by Exodus to work in Exodus' Collections Taskforce, where he remained until October 2001.

(c) **CW3** - CW3 was the Vice President of Service Operations at Exodus from the end of 1999 to the beginning of April 2001. CW3's responsibilities included overseeing all aspects of service operation's "Operating Measurements and Metrics" and the "War Room" (which was essentially the customer complaint department). CW3's Operating Measurements and Metrics responsibilities consisted of compiling information on all customer rates of renewal, cancellations, and complaints.

(d) **CW4** - CW4 was a financial analyst for Exodus from October 1999 until January 2002. CW4's responsibilities included monitoring costs and revenue for individual service centers, and to produce budget forecasts for the centers. Although CW4's coverage primarily included data centers in Seattle, and occasionally for centers in the Bay Area, Irvine, Texas and Chicago, by late 2001, CW4 was involved with P&L and forecasting work for all of the North America regions. At one point, CW4 was also assigned to investigate and resolve a salesperson's disputes over his commissions.

(e) **CW5** - CW5 was the Senior Manager of Credit and Collections for Exodus from June 2000 through May 2001. CW5's responsibilities included generating bad debt reserve reports and revenue reserve reports. CW5's responsibilities also included communicating with collections personnel to determine whether certain debts could be collected.

(f) **CW 6** - CW6 was an account executive for Exodus from February 2000 through April 2001. CW6 was responsible for selling all of Exodus' products and services to customers in the Pacific Northwest Region. CW6 followed the sales cycle from start to finish, and maintained the accounts after they were landed.

(g) **CW7** - CW7 was an account executive with GlobalCenter before it was acquired by Exodus. CW7 continued with Exodus in this capacity from January 2001 through May 2001. CW7 was primarily responsible for bringing in new business and upselling additional services to customers. Once an account was landed, CW7 would maintain the accounts.

(h) **CW8** - CW8 was a marketing operations manager for Exodus from December 2000 through August 2001. CW8 was responsible for many support functions within the Marketing Department. CW8 was also put in charge of integration of the GlobalCenter acquisition within the Marketing Department.

(i) **CW9** - CW9 was the Vice President of Facilities for Exodus from February 1997 through October 2001. CW9's responsibilities included project development, including acquisitions, data center builds, real estate and construction management, and mechanical and electrical engineering management. CW9 supervised nationwide building development and maintenance issues for Exodus. In March 2000, CW9 put together a capital plan for Exodus.

(j) **CW10** - CW10 was a Credit & Collections Analyst for Exodus from July 1998 through the end of June 2001. CW10 was initially hired as a collector and assigned to collect outstanding invoices from Exodus customers. In mid-1999, CW10 also became responsible for determining the creditworthiness of customers. As a Credit & Collections Analyst, CW10's responsibilities primarily involved running credit checks on prospective customers.

(k) **CW11** - CW11 has been a Credit & Collections Analyst for Exodus since August 1999. CW11 was the sole Credit & Collections Analyst assigned to the "Strategic Accounts" group which consisted of Exodus' high profile customers until the Collections Task Force, or the "Customer Care Center" group, was formed in June 2001.

(l) **CW12** - CW12 was a collector at Exodus from the end of 1998 through September 2001. In early 2000, CW12 was promoted to Sr. Collection Specialist.

REASONS WHY DEFENDANTS' STATEMENTS WERE FALSE AND MISLEADING

A. Exodus Entered into Transactions with Non-Creditworthy Customers

105. During the Class Period, Exodus entered into numerous contracts with non-creditworthy customers, and customers who could not otherwise afford Exodus' services, in order to show revenue growth. According to CW1:

(a) At the very beginning of January 2000, Exodus implemented a new compensation plan for its sales force. CW1 had just joined the company at this time, and became immediately familiar with the plan through conversations with Senior Vice President of Finance Mike Healy. As a controller for Professional Services, it was necessary for CW1 to know the details of all sales transactions, as well as employee compensation, because he controlled or "owned" the P&L for the entire Professional Consulting Services organization.

(b) Revenue for Professional Services was historically delineated as both monthly recurring cost ("MRC") and non-recurring cost ("NRC"). Typically, in a Professional Services agreement, 95% of the associated contract value (revenue) had historically been booked within one quarter. The services provided by Exodus were normally architectural design and installation of equipment in a "cage" which had been leased by a customer within an Exodus IDC. The cost of the equipment was invoiced through the Professional Services Organization, along with the services performed for installation and implementation of web-hosting operations. Approximately 5% of the pricing and revenue associated with a Professional Services deal would be appropriately scheduled and invoiced over twelve months, at which time the service agreement would come up for renewal. This small portion of service revenue was primarily to pay for a monitor - an Exodus employee at the data center who monitors volumes of electronic traffic, and can inform any given customer when their website is crashing.

(c) According to CW1, in January 2000, Exodus' sales compensation plan was changed to incentivize the sales force to "dress up" NRC deals as MRC deals, allowing the customer to pay for the entire installation and services over twelve months. Exodus financed the deal for customers in this way, structured along with "side agreements" where the sales force was encouraged to tell customers that if they decided not to continue utilizing the equipment or leased space after ninety days, they could cancel and Exodus would "debook" the transaction. This practice resulted in Exodus financing many deals that customers obviously would not have been able to afford and pay for up front. CW1 learned of such side deals through conversations with various other sales and finance employees.

(d) Exodus urged its sales force to structure deals this way in order to accommodate the growing number of uncreditworthy or cash-poor companies, especially in the dot-com sector, and to create the appearance of growth for Exodus. In the new sales compensation plan, Exodus gave its salespersons "quota protection" for the entire value of these deals, even though the customer lacked the financial resources to pay for the entire order. For example, a salesperson who had a 17.5% commission up to $10 million would get a 22% commission if he exceeded $10 million. It was very important for salespersons to increase their commission level. While salespersons would only receive commissions for months that customers did pay, if a customer cancelled the order, the salesperson still receive credit for quota purposes for the entire amount of the 12 month sales agreement. Once a customer pulled out of the deal, Exodus' profit margin was severely affected. For example, in a $1.2 million Professional Services deal, Exodus would likely invest about one-third of that or $400,000 in design work and equipment. If the customer paid for only 90-days (three payments at $100,000) and then pulled out pursuant to a side deal, Exodus had over $400,000 in costs (including labor) but received only $300,000 in revenue.

(e) The end result was that more customers were enticed to enter deals structured as MRC, especially those who would not have had the cash available or could not find a creditor to finance the expensive design work. Salespersons were credited against their quotas for the entire amount of the transactions, but Exodus accounts receivables ("A/R") became inflated with invoices that would never be paid. With the new compensation plan and directive to structure deals as MRC, salespersons were at least assured of quota relief, even in the case of customers who canceled or would not pay when these costs were amortized over twelve months.

(f) By the first or second quarter of 2000, CW1 discovered that Exodus' order management system had continued to create monthly orders against Exodus' agreement with its customer and to generate invoices as if the deal were proceeding per the agreements, even if the customer had cancelled. In turn, Exodus recognized revenue upon invoicing procedures for the Professional Services portion of Exodus agreements. However, this revenue was "completely false."

(g) The same practice of false revenue recognition for non-paying or canceling customers occurred with Exodus' revenue as well. Since this portion of Exodus' business accounted for over 80% of gross revenues, the dollar value of inappropriately recognized lease revenue was far greater than the Professional Services piece. As Exodus moved through fiscal 2000 and into fiscal 2001, the percentage of false revenue associated with MRC invoicing - for both Professional Services and leases - ramped at an accelerated level as the primary sector of Exodus business - the dot-coms - became unstable and insolvent.

(h) During the Class Period, CW1 raised the MRC issue with other Exodus executives, including, Hancock, and "took a healthy beating" whenever he raised the issue. CW1's confrontations with the executive management team - in particular in Monday morning meetings attended by all of the Individual Defendants - became so adversarial that he was dismissed from attendance shortly after the close of the second quarter of 2001. His statements to the executive defendants during the first and second quarters included his concerns that Exodus continuously failed to establish a reserve for customers known to be non-creditworthy with A/R aged over 60 days (to as much as one year) and that, nevertheless, Exodus had continued to invoice and recognize revenue.

(i) CW1 also had many discussions with Mike Healy (Senior Vice President of Finance) and Susan Colvin (Controller) regarding Exodus' failure to establish reserves, to debook "bad" receivables, and the lack of creditworthiness for certain customers that Exodus extended credit to in MRC structured deals. In most cases, customers that canceled after 90 days and before the end of the agreement period (typically 12 months), usually stopped utilizing Exodus' services and, therefore, discontinued payments for all service and lease related invoices.

106. Another former Exodus employee, CW10, who was involved in Exodus' credit and collections, also confirmed that Exodus structured NRC as MRC deals in order to accommodate non-creditworthy customers. According to CW10:

(a) Exodus implemented a change in the compensation of its sales in early 2000. According to CW10, prior to fiscal year 2000, once installation was complete and installation invoices were created, the Salespersons received 40% of the total calculated commissions for the sale, and the remaining 60% of the commission were then paid to the salesperson on a pro rata basis over the life of the agreement - usually 12 months. Prior to fiscal year 2000, commission were not paid if a customer cancelled, and commission payments were reversed for invoices that were not paid, or "debooked."

(b) According to CW10, this change helped Exodus reach the smaller dot-com companies that could not afford to be installed in an IDC. Since Exodus was now financing the entire transaction by structuring both lease and installation payments over a 12-month term, the creditworthiness of customers should have become more important to Exodus. Instead, most of the new customers, primarily Internet companies, were not creditworthy for the types of monthly payments they were required to make in connection with their purchases from Exodus, but these deals were "pushed through" by senior management after rejections by the Credit & Collections and Finance Departments. According to CW10, Mohamad and Hancock were regularly involved in directing that these high-risk deals be made, and Senior Vice President of Finance Mike Healy was forced to approve virtually everyone who "walked in the door."

(c) In early 2000, CW10 assisted Exodus in creating a credit analysis form, which detailed a customer's financial status. Bank account information and balances were itemized, venture capital firms and committed investments were referenced, as well as vendor contacts and references. For Exodus to execute a sales agreement with a new customer, an authorizing signature on the customer's credit analysis was required. According to CW10, typically, the dot-coms and start-ups were not creditworthy, because they had limited cash, limited or no other available venture capital, no credit history or poor credit, few or no references, with products still in development. Her immediate manager, Jeff Ploshay, would not sign off on these deals, and the credit reports were elevated to Senior Vice President of Finance, Mike Healy. As the primary Credit & Collections Analyst for Exodus, CW10 was in regular communications with Ploshay, and sometimes Healy, over the ultimate decisions of executive management regarding noncreditworthy customers. She was informed that Hancock personally approved a majority of noncreditworthy customers. If approval did not come from Hancock, approval would come from Mohamad, Dollahite, and sometimes Case or Stoltz. According to CW10, the highest risk customers - which could not be approved by Healy because they had such poor credit and cash conditions - were routinely approved by Hancock, Case, and/or Stolz. According to CW10, nearly all of the dot-coms that had gone bankrupt during the 1999-2001 time frame, had been Exodus' customers.

(d) As of early 2000, the Credit & Collections Department prepared a "Credit Analysis form" for each prospective new customer of Exodus. The form included a Dunn & Bradstreet derived credit analysis, if any. Usually the prospective customers were too new or too small to be recognized by Dunn & Bradstreet. According to CW10, a review of these forms for a majority of Exodus' customers showed that Exodus was at great risk for long-term success.

B. Exodus' Financial Results Were False Because Exodus Continued to Record Revenue for Customers Who Had Canceled Their Orders

107. During the Class Period, Exodus' financial results were false because it continued to record revenues even after customers had canceled their orders. According to CW1:

(a) Exodus' billing system could invoice customers "in perpetuity." Unless someone were to physically go into the system directly to perform a "debook," the system would continue to bill for years. Even though the original agreement might specify a 12-month order, the system would continue to invoice at the same monthly rate after the twelve months, unless someone physically input the changes. In addition, sales contracts involved language that the agreements between Exodus and its customers would automatically renew at the end of twelve months unless customers formally notified Exodus of non-renewal. However, in practice, customers would generally just cancel at some point without formal notification to Exodus as provided under the agreements.

(b) Although Exodus knew that customers had cancelled and were not paying invoices, Exodus would not contact customers to verify cancellations for purposes of changing the order system and discontinuing the invoice process. Typically, customers would just ignore Exodus invoices after having cancelled, due to the side agreements made with Exodus. Once Exodus' Collections Department got involved, the customer's A/R could be as much as 180 to 270 days owed. When the customers were finally contacted by Exodus for payment, their response to Exodus, if any, would simply be that they were not going to pay the bill and were told they did not have to.

(c) Even though Exodus' sales contracts, including the lease portion of the agreements, looked "ironclad," beginning in early 2000, Exodus began to establish a track record of "letting companies off the hook." This should have put into question Exodus' entire revenue stream.

108. CW10, another former Exodus employee, also corroborated that Exodus continued to invoice and recognize revenue on customers who had cancelled their services:

(a) According to CW10, many customers cancelled at some point during the 12-month period of the sales agreements and were allowed to do so as a result of side agreements made with Exodus customers by the Sales Department under Mohamad. CW10 learned that Sam Mohamad encouraged the sales force to tell customers that Exodus would allow them to cancel agreements and pull out of IDCs after 90 days, if, for whatever reason, they did not desire to continue using the Exodus services throughout the life of the agreement. Upon attempting to collect on bad debts, collectors heard this over and over again from Exodus' customers.

(b) When customers could no longer afford to meet the terms of their agreements with Exodus, many would move out of IDCs "overnight," but invoicing would continue even though the customer's equipment had been pulled out and Exodus was no longer performing services. According to CW10, regardless of whether customers informed a sales rep or anyone else at Exodus about cancellation, a large percentage of those that did cancel actually moved out of IDCs, and this activity was known to Exodus management through emails between IDC management and corporate.

(c) The Solomon system continued to invoice customers that no longer utilized Exodus services. These customers were no longer installed in Exodus IDCs and already owed Exodus for receivables that had aged 60 - 90 days, and beyond. Collectors learned of cancellations from customers, rather than Exodus' own systems, once collectors tried to collect outstanding A/R for customers that pulled out.

(d) As Exodus customers received invoices for deals that had been cancelled, or services not performed, it would take approximately three months before collections would be in touch with customers to determine the reasons why customers were not paying. Many informed the collectors that they had previously alerted the Exodus salesperson responsible for that customer of elections to cancel deals, or that they were disputing invoices for certain reasons. Then the Credit & Collections Department would contact the salesperson, who would admit that they had received these communications from customers, but had "forgotten" to tell the Accounting Department.

(e) The witness believes that approximately 80% of the revenue reported by Exodus during fiscal year 2000, and through the end of the Class Period, was largely fraudulent. In many cases the entire amounts of invoices recognized as revenue were not collectable, and in other cases, only portions of the invoices were collectable or actually owed by customers.

109. Similarly, CW11 confirmed that Exodus was invoicing customers who had cancelled their services.

(a) CW11 recalled that the collectors at Exodus referred to themselves as being "the last to know." It became a common, daily occurrence for them to contact customers about old A/R, and be told that the customer had cancelled months earlier. Since Exodus was understaffed on collectors, it was not unusual for a customer to go from three to five months without paying without being contacted by a collector. Once a customer was contacted, the customer would refer the collector to the account executive, who had been informed of the pull-out. The account executives many times would claim that they forgot to tell accounting.

(b) According to CW11, Exodus was a completely sales driven company. Because cancellations affected revenue and commissions, Exodus' management from Mohamad to the executive officers ignored it for as long as possible.

(c) Based on the number of accounts in Solomon during the Class Period, and that fact that about half of those invoiced had actually cancelled, CW11 estimates that about 40% to 50% of the revenue recognized during the Class Period was inappropriate. According to CW11, much of the bad A/R was written off after the Company went bankrupt.

C. Defendants Misrepresented the Number of Exodus Customers

110. Exodus also misrepresented the number of customers it had. According to CW11 and CW12:

(a) Exodus had two systems, Solomon and Siebel. In the Solomon system, each customer of Exodus was assigned to the Credit and Collections Department once becoming a customer. Solomon was highly accurate as a historical database for Exodus customers. A collector was given responsibility to monitor payment history and collect against any invoices aged 60 days or more. In the Siebel system, the order management system, a customer list was also maintained, but the list also contained sales inputs for potential customers. Solomon reflected actual customers which had signed Master Sales Agreements with Exodus. Siebel did not.

(b) When Hancock asserted that Exodus had over 4,500 customers, this was false for two reasons. First, she was referring to the number of customers in the Siebel database, which included potential customers identified by contacts with the sales force. On the other hand, Solomon reflected an actual 3,500 or so customers. Second, of the 3,500 customers in Solomon, over 1,500 customers were formally cancelled by Credit & Collections after the Class Period because collectors had determined that these customers had pulled out of deals and data centers from the fall of 2000 through the end of the Class Period. Despite these pull-outs and cancellations, Exodus had continued to invoice and recognize revenue until collectors manually cancelled the accounts in the Siebel and Solomon systems. Thus, contrary to the representation that Exodus had about 4500 customers, there were in fact only about 2000 customers.

C. Exodus' Revenue Was Inflated Through Barter Transactions and Other False Accounting

111. During the Class Period, there were some specific transactions that resulted in false revenue recognition and false accounting. According to CW1, the following examples are only a sample of the total transactions that resulted in significantly material amounts of revenue that should not have been recognized:

(a) **Oracle** - In approximately the fourth quarter of 1999, Exodus entered into a barter transaction with Oracle. The end result, according to CW1, was that both companies "grossed up their revenue" on which there were no real sales for either party. Included in the deal was the purchase by Exodus of Oracle licenses in the amount of approximately $5 million, which Exodus had no need for and would never use. In exchange, the witness believes Exodus invoiced Oracle for "services rendered," which were never performed, and the two companies effectively swapped invoices. According to CW1, the revenue recognized from the Oracle deal had no cost associated and, therefore, the total amount went directly to net income (or to offset asset loss). CW1 recalled that in approximately December 2000, newly hired Chief Operating Officer Don Casey "just lost it" over what he had learned about the Oracle deal. Casey demanded that Hancock, Dollahite and Case immediately debook the Oracle licenses as an asset, saying that the purpose of the Oracle transaction was obvious and that there was never any real need for, nor usable and or sellable Oracle leases purchased. According to CW1, to make this barter transaction appear as a legitimate sale and purchase, Mike Williams (Vice President of Sales), and Sam Mohamad (who had come to Exodus from Oracle) were involved arranging this transaction.

(b) **Innoventry** - In approximately the first quarter of 2001, CW1 was approached by an Exodus employee regarding a barter deal involving this small Silicon Valley start-up worth approximately $800,000. This employee told CW1 that Innoventry had no cash and appeared to be struggling, and that he did not feel comfortable signing off on the deal to finance Innoventry on an MRC basis. After reviewing some data, CW1 agreed. However, CW1 was informed by Bencat Bhamidipati, a Finance "business partner" for Dollahite, that "Ellen (Hancock) really wanted this deal and was going to do it. She believes it is an important customer." Although CW1 informed Bhamidipati that all of Exodus' customers are important, but this customer had no money, and it was clear that Exodus would never be paid, revenue was recognized for Innoventry during the first and second quarters of fiscal 2001 because Mohamad, in charge of sales, pushed the deal through. CW1 believes that the Innoventry deal was a barter transaction in which Exodus purchased software licenses from Innoventry that were unneeded, and in turn, invoiced Innoventry in an MRC type of transaction over the next twelve months or so for installments on this $800,000 transaction, and recognized revenue associated with the invoices. CW1 does not believe Innoventry ever made any payments to Exodus whatsoever, nor did Exodus to Innoventry. Sometime during the second half of 2001, the Innoventry deal was debooked.

(c) **Alta Vista** - The original sale for Alta Vista had been placed in approximately forth quarter 1999 or first quarter 2000. Alta Vista was a spinoff of CMGI, a technology company, and was created as a Netscape-type of search engine. CMGI was Alta Vista's primary and possibly sole source of funding, and by first quarter 2001, it became public that CMGI was going under financially. The original deal with Alta Vista provided Exodus with $179,000 per month in continuing revenue. CW1 recalled that the deal had been renegotiated down to $149,000 per month as of June 2000. However, in first quarter 2001, with the news about CMGI, Alta Vista itself became insolvent and stopped making payments. CW1 believes that Alta Vista canceled its agreement with Exodus pursuant to some sort of side agreement between the two companies. By second quarter 2001, Alta Vista already owed Exodus several hundred thousand dollars, and some of it had been aging since at least fourth quarter 2000. CW1 called the CFO of Alta Vista and arranged for a meeting to discuss the deal and Alta Vista's outstanding invoices. CW1 went to Alta Vista sometime during the second quarter of 2000 and met with its CFO. Alta Vista's CFO informed CW1 that he had been a victim of a "bad deal." The CFO stated that he had never approved the deal on behalf of Alta Vista and, somehow, someone below him had been manipulated by an Exodus salesperson and that Alta Vista had little use for Exodus. Following the meeting, Alta Vista immediately restructured the deal, and within a quarter or so, "kicked Exodus out." CW1 stated that during first and second quarters 2001, Exodus reassigned monthly revenue for invoices that would never be paid, of which Exodus was aware.

(d) **Niku** - Niku and Exodus entered into a barter deal, whereby Exodus purchased a software license from Niku for approximately $417,000. In turn, Exodus invoiced Niku "for services rendered" in the same amount, and Niku wrote Exodus a check for $417,000. In fact, no services had been performed. Since this transaction was done under the umbrella of Professional Services, CW1 became involved. According to CW1, the transaction occurred on approximately December 27, 2000, at which time the entire dollar value, $417,000, was recorded as revenue. CW1 recalls that this amount was debooked in later 2001. He described that the company "left this credit hanging out there" to avoid debooking revenue during the Class Period. CW1 had discussions with Sam Mohamad regarding this transaction, and learned that Mohamad was spearheading the entire barter transaction in which the two companies agreed that "we'll buy your product if you buy ours." According to CW1, neither company ever had any intention of using the other's product. Ultimately, CW1 himself wrote off the $417,000 in revenue associated with the fictitious sale to Niku at the direction of Mike Healy, the Senior Vice President of Finance. CW1 recalled that Mike Healy rejected the Niku deal from the beginning, but was pressured by Mohamad to ultimately give approval. Additionally, the Vice President of Sales, Mike Williams was directly involved with this transaction. A statement of work was actually prepared by Stu Elefant, a pre-sales director who was to obtain a bonus for his team (approximately 10%) for closing this deal. The preparation of the statement of work was in reality an unnecessary exercise, but only done to further create an illusion that some effort had been expended. Although the $417,000 amount might be insignificant in terms of the Company's gross revenues, deals like these were very important because these amounts "blow straight through to net income."

(e) **Vulcan** - Exodus entered into an agreement with a Silicon Valley customer, Vulcan, in early 2000. The salesperson handling the deal was Chuck Lambreau, and Sam Mohamad was also involved. The deal was made between Lambreau and his sister, who worked at Vulcan in the IT department. Vulcan, a customer as of first quarter 2000, continued to be carried as a customer through the end of 2001, when the revenue associated with the deal, approximately $1 million, was written off because Vulcan had never paid. According to CW1, some of the revenue recognized associated with Vulcan was false because Exodus was not performing any services and because Vulcan was already well in default - perhaps one or two quarters - on Exodus A/R. CW1 attempted to get in touch with responsible management at Vulcan and could not get his calls returned.

(f) **SANrise** - SANrise was a deal that resulted in Exodus' booking of $39 million in revenue, which was executed in January 2001. The deal was orchestrated by Vice President of Marketing Bruce Talley, Mohamad and Healy. CW1 received an email from Healy's organization indicating that McCarthy's Professional Services organization would be allocated a total of $3.6 million as Professional Services revenue. This amount was allocated between various regions, including the Western, Eastern and Southern U.S., EMEA and the South Pacific. CW1 responded that he had no hours billed by the Professional Services organization with respect to this deal, but was told that this was an accounting decision which had been made by upper management. In fact, the deal was not for any leases or spaces ordered by SANrise. SANrise, a storage company, was purchasing the Exodus "Data Vault" because Exodus had been operating its own storage component without success. In essence, SANrise was purchasing Exodus storage-related business (customers and some hard assets) only. Exodus receivables associated with the same were not included in the deal. CW1 learned that SANrise was not a cash-rich company and that in exchange for the Data Vault purchase price, Exodus received approximately 20% ownership in SANrise. CW1 does not believe that any dollars ever changed hands, that the 20% interest in SANrise was a stock transaction in exchange for the Data Vault. According to CW1, the $39 million value of the deal (which he believes to have been fictitious) should have been accounted for as an extraordinary item, or a discontinued operation. Instead, Exodus recognized the amount as revenue on its P&L on an MRC basis. He stated that this transaction was really an asset sale, where Exodus sold off a part of its business, but the executive management team wanted to take the amount as revenue over time in order to "massage the numbers." CW1 recalled that the SANrise deal was discussed in executive management meetings, probably during first quarter 2001. Case, Hancock, Dollahite, Williams and Healy concluded that through the accounting entries described above, Exodus could make the SANrise transaction appear as regular and ordinary income over time, rather than taking the related charge or income below the revenue line on the P&L. CW1 believes that the revenue recognized relating to the SANrise deal was ultimately debooked in fourth quarter 2001. Somewhere around that time, SANrise became non-viable, and there were stories circulating about this company joining the list of technology start-up failures. The SANrise transaction was large. In an internal Exodus document entitled "Exodus Operations Summary," dated January 24, 2001, under the section "North America Top 10 Customers," SANrise was listed as Exodus' largest customer, accounting for 2.8% of the Company's MCR in North America. Also, according to a SANrise press release dated June 26, 2001, defendant Marshall Case was hired as SANrise's CFO after his departure from Exodus.

112. CW10 also confirmed that Exodus inappropriately recognized revenue on many barter transactions during fiscal years 2000 and 2001. According to CW10, many times, collectors were unaware that a barter arrangement existed, and would simply begin contacting customers because of aged A/R. Once a collector became aware of, and confirmed the barter deal by speaking with both the customer and the Exodus sales rep, collectors submitted emails to accounting indicating that the dollar amount (value) of the barter-related invoices should be taken out of A/R. However, while A/R was reduced and therefore had a positive effect on Exodus aging, revenue was not debited or reduced. Therefore, Exodus continuously carried and reported revenue associated with barter transactions in the full amount of invoices for which cash was never collected. According to CW10, the dollar amount (value) of revenue invoices associated with barter deals was "in the millions and millions" for fiscal 2000 and fiscal 2001, including:

(a) Inktomi - According to CW10, Exodus and Inktomi engaged in a practice of swapping invoices for approximately $500,000 at quarter-end simply to add to each other's revenue for the quarter. CW10 stated that neither invoice was ever paid and Exodus carried the Inktomi receivable on A/R for as long as executive management wished, prior to issuing credits for the inflated invoices. According to CW10, at quarter-end, Stoltz (and sometimes Healy) informed her of an amount that should be taken out of Inktomi's oldest receivables and accounted for as a barter. According to CW10, this is how dollar amounts or values of barter transactions were typically communicated to the Collections Department, as there were no reports or forms associated with identification of barter transactions at Exodus. Typically, the directive came from Ploshay for most accounts, indicating an amount that had been determined at upper-management levels to be a barter.

(b) StorageNetworks - According to CW10, StorageNetworks, like SANrise, provided Exodus customers with data storage and backup services. As a result, much of the revenue associated with StorageNetworks was actually accounted for through barter transactions. Exodus invoiced StorageNetworks for services performed for Exodus customers, and StorageNetworks invoiced Exodus for space and bandwidth. CW10 estimated that at least 80% of the revenue recognized by Exodus for invoices sent to StorageNetworks was accounted for on service swaps in the same type of barter accounts performed under the Inktomi and SANrise accounts.

(c) StorageWay - According to CW10, StorageWay became an Exodus customer sometime in 1999. She recalled that the company had very bad credit, no money, and was approved by the Exodus executives because it provided storage and backup services for Exodus customers. A/R for StorageWay was largely accounted for through barter transactions, although Exodus recognized revenue on invoices in the same way as it did for storage and data backup vendors - SANrise and StorageNetworks.

D. Exodus' Revenue Was Inflated Because It Invoiced Customers for Services Before Installation Had Been Completed

113. According to CW10, Exodus invoiced and recognized revenue from customers even before it had completed installation:

(a) The sales process at Exodus was that when a salesperson closes a deal, an order is entered into the Exodus Order Management System (Siebel). The order defined all hardware and services to be provided to the customer, for the equipment, installation, connectivity and bandwidth monitoring associated with the customer's use of an Exodus IDC for its Internet operations. The Project Management Department and Professional Services Department both generated their own "installation reports." These reports were supposed to reflect that equipment, connectivity, and other initial efforts to set-up a customer in an IDC, had been performed. According to CW10, the Exodus agreements provided that Exodus would begin to invoice customers for monthly payments once they had been properly installed in an IDC and connected to the Internet in a manner which the customer could then begin actually utilizing the Exodus web hosting capabilities.

(b) These installation reports, which triggered that onset of monthly invoicing and revenue recognition, were false. Sam Mohamad, working with management of the Professional Services and Project Management Departments, instituted a practice to generate these installation reports prior to installation work ever beginning. According to CW10, nearly all Exodus customers were invoiced for installation that did not occur until approximately three months later, usually in the next quarter. By the time these invoices aged, and collectors began to call customers, the first three months of invoices -which were false - had now aged some 90 days. As a result, three, four, or five months after the fact, the collectors were learning from customers that actual installation dates were three months beyond what was reflected on the installation reports, and that the customers did not owe payment for the first three invoices (or so) because Exodus sales agreements provided for payments to begin only once the installation was complete.

(c) According to CW10, revenue for these false invoices was recognized, and once the falsity was confirmed by responsible Exodus collectors, credits were owed to the customers. However, in order for the Accounting Department to issue a credit, approval was required by upper management. Collectors dealt directly with defendant Dollahite over the issuance of credits. It was Dollahite who authorized whether and when to issue a credit for a disputed invoice. In most cases it took at least seven months between the date of the false invoice (based on a false installation report) and the date a credit would ultimately be issued. The witness recalled that sometimes credits were not issued for over one year. CW10 believes these delays in credits were a result of the executive defendants' practices to manipulate revenue reporting.

(d) Upon discovering that these false installation reports had been responsible for false invoices - which customers now disputed - collectors emailed Ploshay indicating that a credit issuance was required. However, Ploshay would either email a response or verbally inform collectors that he could not authorize a credit until Dollahite gave approval. Collectors then, on many occasions, continuously emailed Dollahite through months or quarters, reminding him that a credit was needed (including the reasons, the amount, and the customer involved). Once Dollahite gave approval, the collector made the actual accounting entries into the Exodus accounting system, Solomon. According to CW10, the entry included a credit to customer's A/R, and a debit to revenue. The credit was always made against the oldest (or most aged category of) A/R for that customer. According to CW10, the practice of falsifying installation reports to reflect that installations and services had been performed solely in order to begin generating invoices, gave Exodus "extra revenue" to work with every quarter, and credits would usually not be issued until at least the next quarter, and as much as one year or more thereafter.

(e) According to CW10, the generation of false installation reports was automatic as new sales agreements were executed, and all customers were subjected to false installation reports. Because Exodus was so "revenue hungry," this practice enabled Exodus to begin invoicing and recognizing revenue right after new sales were entered into, rather than to delay the process until installation was actually completed.

114. CW12 also confirmed that Exodus had improperly invoiced customers prior to installation:

(a) CW12 stated that Exodus' invoices to customers consistently included various types of overcharges. Customer disputes over those charges were almost always correct, and resulted in a credit owed.

(b) In particular, customer that ordered new installations in IDCs were consistently invoiced prior to installations having been completed, and many times prior to even beginning. This meant that Exodus was able to recognized revenue for installations, which typically were not completed for 2-4 months after Master Sales Agreements were executed. By the time those initial invoices which falsely billed became aged 60 days, 4-6 months had elapsed. Collectors were consistently informed by customers that the reason the invoices were not paid was because those amounts were not owed.

(c) CW12 also confirmed that Exodus did not timely approve of credits. According to CW12, Susan Colvin told collectors in month-end Finance/Credit and Collections meetings which occurred during later 2000 and at the end of 1Q 2001, that credits were not being issued because Exodus needed the revenue for reporting its numbers. CW12 specifically recalled that at the end of either 4Q 2000 or 1Q 2001, Colvin stated that the Board of Directors was going to meet, and would be reporting either quarterly or annual numbers. Colvin said that Exodus "needed to keep the money on the books" for reporting purposes, and that was why credits were being held up. According to CW12, it was typical for Colvin to advise collectors at monthly meetings that management did not want to approve credits because of the adverse impact this would have on financial reporting.

E. Other Sources and Facts Corroborate that Exodus Had Engaged in Improper Revenue Recognition Practices

115. Exodus' practice of improperly recording revenue has also been confirmed by other former Exodus employees.

116. According to CW2, who worked on the Collections Task Force set up in 2001 to collect payments from customers, CW2 learned on the Task Force that a lot of the Company's revenues were not real due to overbilling and shoddy revenue recognition practices. CW2 observed a lot of transactions that should not have been booked as revenue, including, for example, customers being charged for eight spaces even though they only had one space, Exodus recognizing revenue on orders that were canceled, and Exodus billing customers on large orders even where the customers had cut back on their orders. Among the debts the Collections Task Force attempted to collect included American Airlines, which owed between $5 and $7 million to Exodus. From being on the Collections Task Force, CW2 learned that in 2001, Exodus was trying to collect close to ***$500 million in debts*** from customers.

117. Similarly, according to CW3, a former employee of Exodus whose responsibilities included overseeing "Operating Measurements and Metrics" and the "War Room" (or the customer complaint department), CW3 was informed by customers that Exodus salespeople were falsifying customer orders, recognizing revenue from the orders, and then later crediting the orders. For example, a salesperson would book $20,000 of Exodus' services to a customer, and then cancel the order before an invoice was generated; if a customer allowed the salesperson to do this, they would get a 50% price break on their order in the next quarter. This practice allowed salespeople to make their quarterly goals, earn commissions or to win sales trips. Even when customers later received credits for the order, no deductions would be made to the commissions paid to the Exodus salespeople. According to CW3, when

he became aware of this practice, he immediately notified CEO Hancock. To his knowledge, none of the salespeople were fired.

118. Likewise, according to CW4, questionable revenue had been recognized. In January 2001, CW4 was assigned by her immediate manager to resolve the complaints by a salesperson, Chuck Lambreau, over his commissions. Her job involved "digging down" to find out the actual orders landed by Lambreau, to determine the actual invoice amount versus the agreed amounts and schedules, and to figure out the adjustments that should be made to his commission. According to CW4, Lambreau was owed commissions for Professional Services sales closed in December 2000 and in January 2001, which appeared to involve "side deals" made between him and Exodus customers. Agreements had been booked for much larger dollar amounts than the actual orders that came in from customers, and it appeared that Lambreau orchestrated agreements to reflect one big order when, in fact, he had agreed that customers could actually order smaller quantities of services over time. Because Lambreau's deals accounted for approximately 40% of the total revenue for Professional Services in the Seattle area, and he was highly protected by Mohamad, Lambreau ended up being paid his full commission because Mohamad wanted to make sure that Exodus kept this aggressive salesman.

119. Additionally, according to CW10, some of the charges to Exodus' customers were in excess to what the customers ordered, including charging customers for installations or bandwidth that were never provided. For example, according to CW10:

(a) Exodus' invoices to Inktomi included excessive bandwidth that Inktomi never ordered. Throughout the Class Period, Exodus invoiced Inktomi approximately $200,000 per month, but only about half of those charges were ever actually owed. CW10 met with the CFO of Inktomi ("Bill"), as well as her collections counterpart ("Sholeh"), on several occasions during her tenure with Exodus. She met with them in later 2000, and then again during the first quarter of 2001, to work out the complexities of what Inktomi actually owed Exodus. By the time CW10 left Exodus in late June 2001, approximately 50% of Inktomi's A/R was still the subject of outstanding credits, and at least 50% of those credits should have been issued by first quarter 2001.

(b) Other customers that were the subject of overcharges for bandwidth and IDC space included Yahoo, Bestbuy.com, Metropolitan Life, Franklin Templeton, Akamai, United HealthCare Services, Microsoft, Deutsche Bank/Alex Brown, and Freerealtime.com. With regards to many of these accounts, substantial credits were owed to the customers but not authorized during the Class Period.

120. Likewise, CW11 corroborated the Exodus had over-billed customers:

(a) According to CW11, some of the large customers he handled were on the "expansion plan" with Exodus. This meant that they might lease 20,000 square feet in an IDC, but initially only installed 5,000. Yet installation reports were generated indicating full installation which triggered invoicing for the entire 20,000 square feet. This became the subject of large credits.

(b) According to CW11, Exodus carried a huge backlog of credits for all types of over-billing and disputed charges, most of which went for months and even quarters without being authorized, as Ploshay waited for Healy or some other executive management to approve the credits. Generally, it averaged about four months from invoice to credit for the high profile accounts. For customers who were owed credits for bandwidth or data storage types of overcharges, the credits took even longer. According to CW11, management was not ready to give up these types of credits because they were substantial - they individually amounted to hundreds of thousands of dollars worth of credits for the months of over-charges.

121. Similarly, CW12 confirmed that Exodus' invoices to customers consistently included various types of overcharges. These overcharges not only included charges to customers prior to installation, but invoices for cages that customers did not occupy, equipment they had not leased or purchased, and bandwidth charges which were inflated or erroneous. These types of issues made up the large numbers of credits that collectors determined were owed to customers' accounts, and revenue which was clearly not owed and not collectable. According to CW12, customers became so upset that they were continuously being invoiced after having proven that they did not owe the money, that they emailed Hancock directly, and even showed up at Exodus demanding to see the account executives in order to put a stop to the continued charges. CW12 was told by customers that they had emailed Hancock demanding that collection activity stop. CW12 even emailed Hancock, on occasion, to verify alleged prior communications between customers and Hancock over collection issues; these emails would include the collection status and the customer's reference to prior communications with Hancock. CW12 has "no doubts" that Hancock and other executive defendants had full knowledge, and were orchestrating Exodus' practice to keep false and uncollectible revenue from being written off or credited, in order to manipulate numbers in Exodus' public financial reports.

122. Other sources also substantiate that Exodus had engaged in improper revenue recognition practices. Storagenetworks, Inc. filed a lawsuit against Exodus in the Court of Chancery for the State of Delaware, Case No. 19127-NC, on September 25, 2001. The lawsuit is based on Exodus' failure to submit payments to Storagenetworks as the billing agent responsible for invoicing and collecting payments from customers for Storagenetworks' services. Storagenetworks also alleged,

> that [Exodus] ***has billed Customers that were not receiving service, and has failed to pass onto Customers service credits issued by STOR***.
>
> In addition, Exodus has engaged in manipulative behavior in some of its past remittances to STOR by, for example, ***post-dating checks to STOR to push them into the next quarter, so Exodus would have more favorable quarterly accounting treatment***.

According to an Exodus report entitled Exodus Operations Summary, dated January 24, 2001, under the section "North America Top 10 Customers," Storagenetworks was listed as Exodus' fifth largest customer, accounting for 1.3% of the MCR in the North America region.

123. Other lawsuits have also been filed by customers against Exodus for wrongful billing and for improperly attempting to collect monies they did not owe. In a lawsuit filed by Xand Corporation against Exodus in the Southern District of New York, Case No. 01 CIV 9027, on October 10, 2001, Xand alleged that it was ***unlawfully billed and invoiced by Exodus*** in the amount of $179,081.66. According to an Exodus report entitled Exodus Operations Summary, dated January 24, 2001, under the section "Northeast Top 10 Customers," Xand was listed as Exodus' ninth largest customer, accounting for 1.7% of the MCR in the New Jersey area.

124. Similarly, in a lawsuit filed by iBEAM Broadcasting Corporation against Exodus in Santa Clara Superior Court, Case No. CV800653, on August 13, 2001, over a payment dispute and Exodus' blockage of access to its equipment, iBEAM alleged: "After the inception of iBEAM's business relationship with Exodus, Exodus implemented a new ***billing system that generated incorrect, duplicate or late invoices to iBEAM***."

125. Likewise, in a lawsuit filed by Paid For Surf Corp. against Exodus in the Supreme Court of the State of New York, Case No. 2001-5342, on August 8, 2001, Paid For Surf Corp. alleged that Exodus wrongfully refused Paid For Surf Corp. access to its equipment even though the ***bills were owed by someone else***.

126. Also, according to a June 4, 2001 *Informationweek* article, a dispute erupted between Exodus and its customer, Ventro, when Exodus refused to allow Ventro to collect its servers from its site, claiming that Ventro owed debt. According to a June 4, 2001 *E-Week* article, based on information from a tipster, Ventro was about to seek a court-ordered injunction from the local sheriff's department to gain access. The dispute was apparently resolved before any legal action took place.

F. Exodus' Days Sales Outstanding Numbers Were Artificially Low

127. During the Class Period, Exodus' financial reporting also consistently reflected an artificially low days sales outstanding ("DSO"):

(a) According to CW1, Exodus' policy required controllers to credit A/R and debit bad debt expense as A/R aged, which preserved the appearance of revenue that was not real. These entries created an expense under the net income line so that although expenses looked higher, revenue still looked artificially better. As a result, revenue and expenses crossed recording periods.

(b) According to CW1, Exodus changed this practice after filing bankruptcy, and began to reserve against delinquent accounts, credit A/R and debit revenue. This change essentially amounted to an admission that Exodus had employed false accounting during the Class Period.

(c) CW1 recalled telling the executive team, during the first quarter of 2000, that Exodus should be establishing reserves and should be debiting revenue instead of a bad debt expense after reporting periods where false revenue was inappropriately recognized. However, Dollahite, Case and Wegner took the position that McCarthy "didn't understand this business," and that the accounting was done appropriately.

G. Exodus' Cash Balances Were Inflated

128. CW1 indicated that Exodus was never able to balance books with respect to cash. According to CW1, during the fourth quarter of 2000, Exodus was $100 million off in cash balances. This was the result of a practice used by Exodus at year-end to call customers and ask if customers had mailed off checks. However, Exodus was well familiar with the practice that companies would hold checks beyond year-end December 31, and not send checks until the beginning of the next year, because the customer companies could then keep more cash on their own books and show better cash balances. By calling customers and asking them if they had mailed a check dated against an invoice dated, for example, in December, the customers would normally state that a check had, in fact, been mailed. This was a "game" wherein both sides understood the rules. The Exodus finance person would get information regarding the check number, amount, and would count receipt of that payment as part of Exodus' year-end cash balance. In this way, receivables were lowered, DSO was improved, and cash balances were artificially high for Exodus. The accounting entry performed upon this fictitious confirmation of a check being sent was that cash was debited, and receivables were credited. Exodus did the same thing with customers whose receivables had aged 60, 90 days or more. As a result, A/R never looked as bad as it really was, and DSO was artificially low - a component that was important to Wall Street's analysis of tech companies. CW1 stated that DSO was "always way lower" than reflected on Exodus financial reports.

H. Defendants Misrepresented the Number of Exodus Customers

129. Exodus also misrepresented the number of customers it had. According to CW11 and CW12:

(a) Exodus had two systems, Solomon and Siebel. In the Solomon system, each customer of Exodus was assigned to the Credit and Collections Department once becoming a customer. Solomon was highly accurate as a historical database for Exodus customers. A collector was given responsibility to monitor payment history and collect against any invoices aged 60 days or more. In the Siebel system, the order management system, a customer list was also maintained, but the list also contained sales inputs for potential customers. Solomon reflected actual customers which had signed Master Sales Agreements with Exodus. Siebel did not.

(b) When Hancock asserted that Exodus had over 4,500 customers, this was false for two reasons. First, she was referring to the number of customers in the Siebel database, which included potential customers identified by contacts with the sales force. On the other hand, Solomon reflected an actual 3,500 or so customers. Second, of the 3,500 customers in Solomon, over 1,500 customers were removed from the database by Credit & Collections after the Class Period because collectors had determined that these customers had pulled out of deals and data centers from the fall of 2000 through the end of the Class Period. Despite these pull-outs and cancellations, Exodus had continued to invoice and recognize revenue until collectors manually cancelled the accounts in the Siebel and Solomon systems. Thus, contrary to the representation that Exodus had about 4,500 customers, there were in fact only about 2000 customers.

130. Likewise, CW12 corroborated that defendants had overstated the number of customers Exodus had:

(a) According to CW12, even though defendants made public statements that Exodus had 4500 or more customers, the Solomon system reflected only about 3500 customers. Further, of the 3500 customers shown as "active" in the Solomon database, at least 1000 of those should have been considered "cancelled," as many of these had in fact cancelled at least several months earlier.

(b) Based on her knowledge that approximately 1000 of the customers listed as active in Solomon were actually inactive and cancelled, CW12 estimates that between 25% and 35% of the revenue recognized by Exodus during the first half of 2001 should not have been cancelled. In addition, another substantial amount of revenue was recognized as a result of false charges and overcharges in invoices sent to customers, which was also not owed and not collectable. CW12 estimates this amount to be another 10% to 20% of reported revenue.

I. Defendants' Forecasts for Exodus Were Made Without Reasonable Basis

131. During the Class Period, Exodus' forecasts were also made without reasonable basis. According to CW1:

(a) On approximately the 20th of every month, a Company-wide profit and loss statement (P&L) was distributed to defendants Hancock, Stoltz, Dollahite, Case (until he left in April 2001, and then Mike Perry), as well as Williams, Healy, and other Vice Presidents and other management. This "financial statement summary" was a package covering eleven months prior to the reporting month, the reporting month itself and twelve months looking forward. The P&L served both as a financial statement based on actuals (or at least accounting as performed) and as a forecast for the following year.

(b) Exodus' forecasting for sales was never reliable. There was just no scientific method or logical procedure used. Instead, the Exodus finance and sales teams assumed forecast numbers that Hancock gave to the Street, which were always completely unrealistic as far as the actual outlook input by the organizations working with customers. The forecast portion of the P&L included a tool - a spreadsheet - that identified potential sales in the Company's pipeline. The spreadsheet included the potential customer name, potential dollar value of the deal and various percentages applied to the probability that the deal would close. For example, 0-10% would involve a deal where Exodus had not yet even spoken to a customer. Where negotiations had begun, and the salesperson thought there was a good possibility that the customer would sign, 25% was assigned. Basically, salespersons would assign percentages by instinct. In addition, 100% of anticipated revenue was assigned for deals that had been executed and where Exodus was beginning work. These percentages were then applied to the total potential value of each deal and added to indicate Exodus' current projection for revenue in the next quarter. Total value of all deal was also summed to indicate a potential for Exodus revenue in the next quarter. For more than one quarter out, if plotted and graphed, the projection looked like a heart monitor sign wave.

(c) CW1 engaged in heated discussions during Monday morning executive meetings with the defendants involving forecasts. The trends in forecasts prepared from inputs by sales and finance organizations showed downward trends from at least June of 2000 through the Company's bankruptcy and continuing in 2001. The forecasted revenue included monthly recurring revenue which the responsible organizations knew to be false or misleading, because associated customers had either gone bankrupt, canceled or demonstrated a growing history of non-payment. Yet, Hancock consistently represented large growth in revenue to the Street for the different quarters and years that CW1 was with the Company.

(d) In the management meetings, CW1 presented projections for revenue from approximately June 2000 through the end of 2001. For example, according to accurate projections, Professional Services might do $32 million in a quarter. In response, usually Healy, Dollahite or Hancock would state that this was not good enough. Then, Hancock would make statements to the Street indicating a substantially higher number, like $37 million. This, as CW1 states, was "how forecasting at Exodus went."

(e) CW1 and other finance personnel called customers daily, called salespeople in the field, and tried to find out how reliable forecast deals were. He believes that the actual numbers provided to the executives were highly accurate. However, the numbers provided to the Street were much higher than Exodus' internally projected numbers.

(f) In the executive meetings, "allocation" was described as the method by which the gross revenue forecast that Hancock had given to the Street, would be allocated to the various revenue generating organizations. Because CW1 insisted that the internal forecasts were accurate and based on accurate information, and he did not care what he was being told to forecast by upper management, these arguments resulted in CW1 being banned from executive Monday morning meetings at the end of June, right after the close of second quarter 2001.

(g) CW1 stated that the MRC sales - which Exodus began pushing in late 1999 and early 2000 - were all written in agreements covering or encompassing a 12-month span. Therefore, the actual projections developed internally showed a large drop in business, at least by first quarter 2001. There was an MRC spreadsheet showing the specific points in time where large groups of deals would fall off, unless customers renewed. As Exodus progressed through fiscal year 2000, it became even more clear that customers would not renew, because the rate of cancellations early in the 12-month agreement was accelerating. MRC related revenue continued to be invoiced and recognized after the 12-month agreements lapsed, because nobody was assigned to go into the order management system and manually cancel the invoicing schedule. If a deal were not debooked manually, invoicing would continue in perpetuity.

132. The fact that Exodus' public forecasts were made without reasonable basis is also corroborated by Exodus internal emails. For example, according to an email dated February 13, 2001 from Rowena Ironside to Bill Yeack, which copied Don Casey, Ted Hull and Sheryl Pearson, the message states: "Bill - I am very concerned that the UK ProServe Target number for Q1 somehow got from a plan of $2.9m and a January 25 flash of $2.5m to a TARGET of $4.1m. Seems that people think you get the credit for agreeing to this - but I know that you know that ***you cant [sic] add 41% to plan and 64% to flash 5 weeks into a quarter in our business and have a hope in hell of making it***."

J. Exodus Was Suffering from High Rates of Customer Bankruptcies, Customer Delinquencies, Customer Cancellations and Lack of Demand

133. According to CW1, defendants knew about increased aging of receivables and failures of dot-com customers beginning in early 2000. The trend was clear, according to CW1, who learned of the risk for this entire sector upon joining Exodus in January 2000. He inherited the P&L for the Professional Services organization and noted immediately within the first quarter of 2000 that expenses were on the increase. When he "drilled down" to identify these expenses, he noticed that the increases were due to the issuance of credits relating to bad debt for customers who had not paid for three to six months or longer. The dot-com problem began much sooner than the problem became known to the public, that even upon the acquisition of Cohesive in 1999, Exodus became aware that it had acquired a substantial amount of bad debt comprising Cohesive's receivables. Bad A/R made for a large portion of Cohesive revenue that had been of primary importance to Exodus for the acquisition to show growth and revenue in the Exodus pro forma P&L

134. By late 2000 and early 2001, the problems with failing dot-coms and bad debts were dramatically impacting Exodus. Nevertheless, defendants continued to portray Exodus in a highly positive light, even as concrete facts indicated that Exodus was suffering from record rates of customer bankruptcies, customer delinquencies, customer cancellations and weak demand.

135. According to CW5, the former Senior Manager of Credit and Collection at Exodus, Exodus significantly downplayed the impact of the dot-com slowdown on its business. Every month, and a once a quarter, CW5 would go through each customer account to determine whether there was collectible revenue. It was her responsibility to generate bad debt reserve reports and revenue reserve reports on a monthly basis, which were typically provided to management by the sixth day of the following month. These reserve reports, which included figures as well as charts, were prepared for the executive meetings. According to CW5, in first and second quarters 2001, there were a lot of customer disputes and delinquencies. She was continuously getting calls to dispute charges. The last reserve report she prepared was for the March 2001 close. Hancock received this report by hand delivery in early April, along with other members of upper management including Wegner, Dollahite and Case. The reserve report showed that ***40% of the overall accounts receivable was not collectible***. After Hancock reviewed the report, Hancock insisted the report had to be wrong, that the number was too high and had to be changed. Hancock told CW5's supervisor, Susan Colvin (the Controller), to change the number. The number was later sent out to the people involved in sales to challenge - but no one challenged the figure.

136. Similarly, according CW4, a former Exodus financial analyst assigned to Exodus' Professional Services segment, the P&Ls for data centers within her responsibility reflected a significant drop in revenue in late March and early April 2001. According to CW4, other employees told her in conversations and through emails during February and March 2001 that dot-com customers were filing for bankruptcy in large numbers, that these and other customers were canceling orders, not making payments to Exodus, and that Exodus' revenues were "way down." Even though revenue was in decline, because some of the dot-com bankruptcy scenarios required Exodus to continue providing services for periods of time without being paid, the P&Ls during the Class Period generally reflected that costs remained the same. Furthermore, despite CEO Hancock's very positive statements concerning Exodus' prospects and forecasts, and positive statements about the Company's transition to new enterprise customers, in both the forecast and P&Ls she reviewed for her data centers during first and second quarters 2001, CW2 did not see this influx of new customers or replacement revenue for dot-coms that had gone out of business. CW2 worked on a "Top Ten Customer" list for the Seattle area, which was submitted to corporate finance along with the P&Ls, and recalled that during second quarter 2001, some of Exodus' "biggest customers" dropped off, including Boeing. At least in her region of the Pacific Northwest, it appeared that Exodus was actually losing some large enterprise customers.

137. Likewise, according to CW3, whose responsibility was to compile information on Exodus' customer base, in first quarter 2001, Exodus' customers were cancelling orders and/or were not renewing orders, and dot-com revenue was not coming in because companies were going out of business or were delinquent in their payments. In first quarter 2001, he saw high customer churn.

138. Exodus sales executives also saw weakness in sales. According to CW6, a former Exodus account executive, he noticed a decline in cancellations at the end of 2000, particularly in the dot-com arena. He also stated that he was having extreme difficulty bringing in new customers, and that he was producing low numbers and was consistently not making his goal. He also estimated that probably less than 10% of the sales force was at their plan or goal by the time he left in April 2001.

139. According to CW7, another former Exodus account executive who received client base listings, which he believed were updated weekly, by the time he left Exodus in May 2001, these client base listings had become noticeably shorter.

140. CW10 also observed high rates of cancellations. According to CW10, she saw Churn Analysis Reports regularly, and saw that the numbers of cancelling customers steadily climbed throughout 2000 and through the Class Period, especially as the dot-com segment went bust. However, CW10 cautioned that the Churn Analysis Report was not accurate with respect to the dates that customers were shown to have cancelled because management would not formally cancel customers within the quarter of cancellations. Instead, cancelled customers were not reflected in the Churn Report until the beginning of the following quarter in order to make the churn look lower than it really was. According to CW10, after the GlobalCenter acquisition closed in January 2001, Exodus' business condition got even worse. There were far less new orders, despite the fact that Hancock was touting Exodus' penetration into the enterprise market. Even though several new and large customers came on board during the first and second quarters of 2001, it was not nearly enough to counter the excessive cancellations and increases in bad debt that she observed in the Collections Department. Further, false billings were getting worse as more and more customers complained about items in invoices that were never ordered or provided.

141. Statements made by defendants after the Class Period also indicate that defendants were aware of Exodus' poor business conditions during the Class Period, as follows:

(a) In Exodus' Bankruptcy Disclosure Statement signed by defendant Wegner, filed with the Bankruptcy Court in the District of Delaware on March 25, 2002, Exodus acknowledged it was aware of the impact of an economic slowdown by at least late 2000. Exodus admitted: "***Beginning in late 2000 and early 2001, economic conditions began to deteriorate, particularly for emerging Internet "dot.coms," and during 2001 many of Exodus's "dot.com" clients failed. Additionally, a substantial number of Exodus's traditional enterprise clients delayed - and in some cases cancelled - purchase decisions***."

(b) Further, in an interview by Jennifer Mears of *Network World*, published by *Network World Fusion* on October 1, 2001, William Krause (who replaced Hancock as CEO on September 4, 2001), highlighted that Exodus was having problems with non-paying customers:

> Jennifer Mears: Obviously keeping customers is a big concern. What are you expecting in terms of customer losses, and what is the percentage of Exodus customers who have some sort of penalty-free exit clause?
>
> William Krause: I have no idea, No. 1, and No. 2, I wouldn't disclose it.... ***But let me also answer your question with, there are some customers that we've acquired that aren't customers. And what I mean by that is, in my definition of a customer you have to meet three requirements. One is that you have to have a need, two is that it's something Exodus can fulfill, so that No. 3, you'll pay us for it. Unfortunately, in this emphasis on revenue growth at any cost, we've taken on some obligations for people who aren't customers. And I'd just as soon have those people burdening someone else's balance sheet. And so we are taking actions, aggressive and swift, to ask these organizations to get their services from someone else***. Let me also be clear, we're not being arrogant about it. We're not being nasty about it. We've giving them time to make a transition, but we're also being very firm that if you can't pay your bills, we can't afford to have you burdening the balance sheet. If there's any decline in our customer base, that's were 90% of it will come from.

(c) In a September 28, 2001 article by Evan Koblentz in ***eWeek***, Krause again acknowledged the degree to which Exodus was affected by customers who failed to pay:

> "***We have a lot of customers who don't qualify to be customers***," he said. "We shouldn't have had them as customers in the first place, [although] ***virtually 90 percent of that [was] self-induced***." Exodus will give notice to such customers "to go be a burden to someone else's balance sheet. If you can't pay your bills, please go away. Quickly," Krause said.

K. Exodus' Internet Data Centers Had Excess Capacity

142. During the Class Period, Exodus' IDCs were operating under capacity. According to CW1, Exodus' statements about customer demand and utilization of space in its IDCs was misleading at best, for the following reasons:

(a) There was no one "clean report" that identified utilization of floor space, but rather breakouts on the IDC P&Ls only represented "revenue per square foot," or "revenue per installed square foot." Despite the Company's statements to the Street that IDCs were full or were expected to be full by certain dates, in reality, none were ever filled up. Customers who had signed up for space would actually debook, or decide to move to a different IDC, and there were always great amounts of unused "raised floor." CW1 recalled an Atlanta IDC having 300,000 square feet of raised floor, where a great amount of this capacity was unused. He also recalled 500,000 plus square feet in the Seattle data center (DC3) that was in a new facility which was not used. According to CW1, he had visited both Atlanta and Seattle and the interior of these data centers was so large one "could land a space shuttle." Both of these facilities were discharged in bankruptcy and sold off.

(b) There were various ad hoc reports, prepared by different financial analysts to show revenue per square foot and install square foot, and these reports were distributed to the executive management team. These reports clearly identified the fact that Exodus was sitting on huge amounts of empty space.

(c) For example, Seattle's only customer for its large new data center was Microsoft. According to CW1, once Exodus executives looked at a P&L for the IDC, reflecting something like $2 million per month in revenue for an IDC known to have 500,000 square feet of raised floor, it should only have flagged the need for Exodus to sell the asset.

(d) According to CW1, Exodus executives desperately wanted to issue new releases about the first customer in a new IDC. Once a customer moved into a new IDC, Exodus made statements to the effect that the IDCs were filling up. According to CW1, "It just wasn't true."

143. Whether Exodus' IDCs were full was readily observable, and even Exodus customers noticed a difference. According to an ***Eweek*** article dated May 7, 2001, Exodus customers like Marc Vigod, the president of VLM, Inc., noticed a decline in the Company's business; the article quoted Vigod as saying that when he went to Exodus' IDC to remove his equipment around late April/early May 2001, "I was surprised to see half the data center empty"; also, according to Vigod, while removing VLM's equipment, an Exodus security guard remarked to him that more customers were seen leaving than entering lately.

144. Statements made by Exodus' executives just before and after the Company filed for bankruptcy also indicate that defendants were aware of the over-capacity of the IDCs:

(a) In Exodus' Motion Authorizing Sale of Substantially All of the Debtor's Business Assets to Digital Island, filed with the Bankruptcy Court for the District of Delaware on November 30, 2001, Exodus admits that some of its IDCs were vacant and/or were not full. The filed document states: "Since the filing of these chapter 11 cases, the Debtors have taken a number of actions to adjust and improve their business and growth strategies in light of changing economic circumstances, including disposing of several nonoperating, redundant or otherwise noncore assets, including ***vacant IDCs*** and office space in the United States and abroad. The Debtors have also curtailed their aggressive growth strategies and, instead, ***have focused on consolidating customers in strategically located sites to increase utilization of IDCs***, reduce overhead expenses and provide a more efficient platform to service customers."

(b) In an interview with Jennifer Mears of *Network World*, published by *Network World Fusion* on October 1, 2001, Krause indicated that Exodus' IDCs were not full, as follows:

> Jennifer Mears: As for the data centers, you're closing 10 that were under construction, but some analysts say more consolidation will be necessary. Will operational data centers be closed?
>
> William Krause: We have nothing to report there. Obviously, we evaluate our business just like everyone else does. We are managing for profitability. In doing so we're going to

look at data centers in terms of, are they providing unique value to our customers, and if so, then we ought to be able to charge for that value a price that is high enough to cover our costs and allow us to make money. Where we have four data centers, such as in the Washington, D.C., area, and ***we've got customers in all four but all are operating under capacity***, if customers didn't care about being moved to one of the other data centers that would be a smart move for our customers and for us. So those are the kinds of things we'd evaluate, but we've not made any of those decisions yet.

(c) Hancock acknowledged the overcapacity of Exodus' IDCs in an interview with ***The Industry Standard's*** Alexei Oreskovic. The interview, published on August 22, 2001, is as follows:

The Industry Standard: Exodus has said it doesn't necessarily agree with analysts' reports of overcapacity in the hosting sector, yet ***many of your data centers are at only 50 percent capacity. That sounds like overcapacity***.

Hancock: You can't just add up all the [unused hosting] space and say, "See you've got all that space left." You need the space in the city or the country, or you essentially lose business in those geographies. So even though we might have some [extra] space in London, that doesn't help us address the French market or the market in Amsterdam or Germany. Last quarter, we opened up four new data centers: one in Amsterdam, one in Paris, one in Dallas and one in Miami. ***So with all this discussion of glut, we're opening up data centers***.

(d) According to another article by Jennifer Mears of *Network World Fusion*, published on September 26, 2001 concerning Exodus' Chapter 11 filing, Exodus' IDCs were operating under-capacity:

Exodus says 27 of its 44 data centers have positive earnings. But analysts note that many of the firm's centers are running at ***capacity levels as low as 10%***. "You can't afford to support the cost of a data center when you're only making revenue on 10% of the space," says Andrew Schroepfer, president of Tier 1 Research.

(e) Sam Mohamad, Exodus' President of Sales, Marketing and Professional Services, later acknowledged in an August 13, 2001 *Tele.com* article that Exodus was opening IDCs before properly ascertaining that demand was sufficient. The article, which discusses data center glut, states:

[M]ost hosting providers are targeting established enterprises instead of dot-coms and moving to high revenue managed hosting services. The change may be sound, but the switch means that sales take longer and involve more senior personnel, says Sam Mohamad, Exodus president of sales, marketing and professional services. It also means that hosting companies don't build on speculation. ***Exodus now opens a sales office before finding a data center location to see if demand is sufficient*** - an approach that Genuity also supports. "***We used to stop at the market analysis phase***," Mohamad says.

(f) Exodus' November 14, 2001 Form 10-Q filing, made after the Company went into bankruptcy, indicated that, during the third quarter ending September 30, 2001, the Company recorded an impairment charge of $746.6 million for certain IDC property and equipment and construction in progress. This is also an indicator that Exodus' IDCs were not fully utilized.

(g) Furthermore, in an October 25, 2001 press release, William Krause also acknowledged, "In assessing our international operations, cost structure and potential for profitable growth, it became clear that ***we were over invested in non-operational or under-utilized facilities in certain markets***."

L. The Acquisition of GlobalCenter Did Not Enhance Exodus' Business

145. The defendants' statement that the GlobalCenter acquisition would "enhance" Exodus' global IDC infrastructure was false and misleading when made.

146. According to CW8, whose responsibilities included integrating the GlobalCenter acquisition within the Marketing Department, based on her conversations with the Vice President of International Operations who worked on the due diligence, the witness learned that the due diligence team led by Vice President of Business Development had ***strongly recommended against the acquisition of GlobalCenter***. The team had examined other potential competitors to acquire and had recommended a different competitor than GlobalCenter. Exodus' Board of Directors, who received these reports from the due diligence team, was against the acquisition, concluding that it would be too expensive and that the business model was "not a good fit" for Exodus. Nevertheless, Exodus' CEO, Hancock, wanted GlobalCenter for its two IDCs in Manhattan, one on 9th Avenue and another on 11th Avenue, which were considered "prime real estate." However, along with these two stellar Manhattan locations, came other GlobalCenter facilities, some of which were largely empty. CW8 learned that the Data Centers in Tokyo, Sydney, another in London and pending openings in Paris and Munich all experienced substantial shortage in demand. Shortly after the close of the acquisition, Exodus decided to cancel the opening of centers in Munich and Paris - neither of which had actually been opened by GlobalCenter.

147. Exodus later acknowledged, in its Form 10-Q dated November 14, 2001 for the quarterly period ended September 30, 2001, filed after the Company's bankruptcy, GlobalCenter's IDCs were operating under capacity. According to the Form 10-Q, "***IDC utilization rates declined recently as a result*** of the slowdown in the number of new customers, the elimination of the Company's financially unstable customers and the Company's ***acquisition of GlobalCenter Holding Co., Inc., in January 2001***."

M. Exodus Could Not Achieve Its Business Plan

148. Defendants' representations that Exodus "has a clear path to profitability," that it would "turn cash EPS positive during the first half of 2002," and that it has a "fully funded business plan" were false and misleading because defendants were aware that Exodus was woefully short of funds required to achieve its business plan.

149. According to CW9, a former Exodus employee responsible for product development, in March 2000, she had been asked to put together a capital plan for the rest of the year. By April 2000, she turned in a plan reflecting the need for $3.2 billion to accomplish the goals set forth by the executive staff. The executives balked at these numbers because, at the time, they only had $750 million to work with. Her plan was dismissed, and Exodus continued building additional centers out, knowing they didn't have the capital to cover the expense of these expansions. In August 2000, Jim Stoddard and an employee in the Finance Division also submitted a capital plan. The second capital plan also reflected the need for $3.2 billion. Thus, by at least August 2000, defendants were aware they did not have sufficient capital to support Exodus' expansion and to accomplish its business plan.

150. Defendants were also aware that Exodus was not fully funded to achieve its business plan because it was quickly burning through cash and its business condition was rapidly deteriorating. By March 2001, Exodus was paying $75 million in quarterly interest on its $3 billion debt, was continuing to spend to execute its merger and restructuring plans, was continuing to build IDCs, and its fixed cost infrastructure and capital spending were much too high in the face of the dramatic decline in industry growth. The

Company used over $450 million in cash and cash equivalents in its first quarter 2001, and even with $1 billion in cash and reductions in capital expenditure, the Company would not have had sufficient funding until it turned cash EPS positive in the first half of 2002 because the Company was having difficulty turning its sales to cash, was suffering net operating losses, and its gross profit margin was falling. Indeed, defendants were aware that the economic conditions were so bleak that many Web hosting companies like itself were seeking strategic alternatives, including: PSINet Inc., which hired financial advisors in November 2000 to seek strategic alternatives due to declining demand and poor business conditions; Digital Island, which hired a financial advisor in August 2000 to assist it in being acquired due to its weak sales and lack of profits being generated from existing customers; and NaviSite, which laid off employees and closed several sales offices. Further, several had filed for bankruptcy. Exodus also later followed the same bankruptcy route.

N. Defendants Were Aware that Exodus Would Violate Its Loan Covenant

151. Defendants' statement that Exodus "will continue to be in compliance with the covenants of [its] bank credit facility" was false and misleading. Defendants were aware that the Company would not achieve its second quarter 2001 guidance because of the poor business conditions then negatively impacting Exodus and because defendants were aware their forecasts were overly aggressive. Consequently, defendants knew that in order to prevent falling out of compliance with loan covenants with Chase Manhattan Bank by falling short of the EBITDA of $35 million that it was required to achieve in second quarter 2001, Exodus was forced to pay back the $150 million it had borrowed, further draining much needed cash.

O. Exodus' Financial Statements Violated GAAP Exodus' False Financial Reporting During the Class Period

152. In order to inflate the price of Exodus' securities, defendants caused the Company to falsely report its financial results included in press releases and SEC filings during the Class Period. Defendants caused the Company to falsely report its financial results in violation of GAAP through: i) improper revenue recognition; ii) overstating accounts receivable; and iii) falsely recording cash receipts.

153. During 2000, as the Internet technology industry began to crumble, Exodus was desperate to report continued revenue growth and devised several schemes to fraudulently recognize revenue. The Company's improper revenue recognition revolved around the control the executive management team had in entering into and approving initial deals with customers and approving changes to be made to existing customer invoicing. This control enabled defendants to: i) invoice and record revenue prior to hardware being installed and prior to Internet connectivity; ii) continue invoicing and recognizing revenue after a contract had been terminated either through customer cancellation or non-payment by the customer; iii) encourage sales personnel to enter into contracts that contained side agreements which allowed customers to "back out" of a deal with no penalties; and iv) continually override credit reviews on prospective customers and thus enter into contracts where collection was not reasonably assured.

154. Further, defendants also entered into or approved bogus barter transactions as a means to boost revenues. The barter transactions were entered into for the sole purpose of increasing revenue. In most circumstances, Exodus either had no intention or need to utilize the bartered asset received; or no assets or services were exchanged - both parties simply agreed to exchange invoices and record bogus revenue.

155. As a result of these improper revenue recognition schemes, by the end of 2000 defendants were

faced with another issue to deal with - growing accounts receivable that were not collectible. In an attempt to hide any "red flags" that an increasing accounts receivable balance would raise, defendants entered into another fraudulent accounting practice - recording fictitious cash receipts.

156. GAAP are those principles recognized by the accounting profession as the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. SEC Regulation S-X (17 C.F.R. §210.4-01(a)(1)) states that financial statements filed with the SEC which are not prepared in compliance with GAAP are presumed to be misleading and inaccurate, despite footnote or other disclosure. Regulation S-X requires that interim financial statements must also comply with GAAP, with the exception that interim financial statements need not include disclosures which would be duplicative of disclosures accompanying annual financial statements. 17 C.F.R. §210.10-01(a).

P. Exodus' Improper Revenue Recognition

157. GAAP, as described by FASB Statement of Concepts No. 5 ("FASCON No. 5"), provides the basic requirements for revenue to be recognizable: (1) revenue must have been earned;[(1)] and (2) revenue must be realizable (collectible). *See* FASCON No. 5, ¶83.

158. Further, the SEC sets forth the following criteria for revenue to be recognized, all of which must be met:

> (a) ***Persuasive evidence of an arrangement exists;***
>
> (b) ***Delivery has occurred or services have been rendered***;
>
> (c) The seller's price to the buyer is fixed or determinable; and
>
> (d) ***Collectibility is reasonably assured***.

See SEC Staff Accounting Bulletin No. 101 - Revenue Recognition in Financial Statements ("SAB 101"). SAB 101 further defines delivery as follows:

> Delivery generally is not considered to have occurred unless the product has been delivered to the customer's place of business or another site specified by the customer.
>
> * * *
>
> After delivery of a product or performance of a service, if uncertainty exists about customer acceptance, revenue should not be recognized until acceptance occurs. Customer acceptance provisions may be included in a contract, among other reasons, to enforce a customer's rights to (1) test the delivered product, (2) require the seller to perform additional services subsequent to delivery of an initial product or performance of an initial service (***e.g., a seller is required to install or activate delivered equipment***), or (3) identify other work necessary to be done before accepting the product.... when such contractual customer acceptance provisions exist, the staff generally believes that the seller should not recognize revenue until customer acceptance occurs....

159. Exodus recognized revenue in violation of GAAP and SEC rules because it:

(a) recorded revenue prior to rendering services;

(b) recorded revenue on cancelled or non-renewed contracts;

(c) recorded revenue from transactions in which collectibility was not probable; and

(d) recorded revenue and assets in conjunction with bogus barter transactions and failed to disclose such transactions.

160. Absent Exodus' improper revenue recognition, it would have reported materially less revenue during the Class Period.

Q. Exodus Recorded Revenue Prior to Installation and Activation of Services and Continued Recording Revenue on Cancelled and Terminated Contracts

161. It was common practice for Exodus to record revenue on contracts prior to proper installation and Internet connectivity. Throughout the Class Period Exodus also continued to record revenue on contracts that had been cancelled or terminated. These transactions were in violation of GAAP and SEC rules as delivery ***had not*** occurred, persuasive evidence of an arrangement ***did not*** exist, and collectibility was ***not*** reasonably assured.

162. CW1 described Exodus' practice of recording revenue on cancelled or terminated contracts and provided the following summary. Beginning in early 2000, in order to create the appearance of continued revenue growth and to accommodate the growing number of customers that did not have the ability to pay a "lump sum" of cash for services, Exodus encouraged its sales force to enter into side agreements and to structure agreements as "Monthly Recurring Cost" ("MRC") deals.[(2)] Although an MRC deal typically covered a 12 month period, Exodus' sales personnel were encouraged to tell customers that if they decided to discontinue service after 90 days, Exodus would not pursue the breach of contract. This practice is important for the following reasons: (1) essentially Exodus was financing deals for its customers that otherwise did not have the ability to pay; and (2) Exodus' order management system, which invoiced over 4,000 customers, was set up to invoice customers "in perpetuity" on MRC contracts. Hundreds of customers that had canceled their contracts or never approved a deal continued to get invoices until Exodus' senior management gave approval to cancel the invoicing.[(3)] As a result, revenue continued to be inappropriately recorded for contracts that defendants knew were cancelled, severely delinquent, or otherwise disputed. Recognizing revenue on deals that clearly do not exist is improper under GAAP.

163. CW10 disclosed that Exodus routinely invoiced and prematurely recognized revenue on deals where completion or start-up of services had not yet occurred. This was done in order to record revenue before the end of a quarter. Further, many of these "pre-invoiced" installations were never performed or the invoices included work beyond what was ultimately installed. The following paragraphs summarize CW10's understanding of Exodus' fraudulent sales practice.

164. As a salesperson closed a deal, an order was entered into the Exodus Order Management System (Siebel). The order defined all hardware and services to be provided to the customer. This included the equipment, installation, connectivity and bandwidth monitoring associated with the customer's use of an Exodus IDC for its Internet operations. The Exodus agreements provided that Exodus would begin monthly invoicing once hardware was properly installed in an IDC and connection to the Internet had

occurred. In other words, monthly invoicing should not have begun until the customer could actually utilize the Exodus Web hosting capabilities.

165. The Project Management and Professional Services Departments both generated "installation reports." The purpose of the installation reports was to indicate that all services related to equipment installation connectivity, and any other initial set-up activities had been performed. CW10 estimated that these installation reports, which triggered the onset of monthly invoicing and revenue recognition, were prematurely prepared or otherwise false in almost all instances because defendant Mohamad orchestrated a standard practice to generate these installation reports ***prior*** to installation work ever beginning. Nearly all Exodus customers were invoiced prematurely for installations ***that did not occur until approximately three months later***, typically the next quarter. By the time Exodus collectors would contact customers at least three months of false invoices had been generated, and therefore three months of revenue had been improperly recognized.

166. The practice of falsifying the installation reports gave Exodus "extra revenue" to work with every quarter. CW10 stated that the generation of false installation reports was as new sales agreements were executed, and as a result, all new customers throughout the Class Period were subject to false installation reports and consequently false revenue recognition.

167. Further, CW 10 stated that defendant Mohamad encouraged the Exodus sales force to tell customers that Exodus would allow them to cancel agreements and back out of IDC agreements after 90 days, even though the agreements were typically for a twelve month period. CW 10 stated that customers repeatedly told this to Exodus collectors when contacted about past due or disputed balances.

168. Defendants' scheme of fraudulent revenue recognition continued even after collection efforts confirmed that customers had been fraudulently invoiced and were therefore owed credits, which when issued would result in a reduction of revenue and/or net income. Before a credit could be issued, approval was required by upper management, specifically defendant Dollahite. CW10 stated that in most cases it took at least seven months, and in some cases more than a year from the date a false invoice was generated to the date a credit was ultimately issued.

169. CW12 confirmed defendant's practice of delaying the issuance of credit memos.

170. CW12 specifically recalls at least two meetings that Colvin held with collector during each of the first and second quarters of 2001, one of which occurred within a week of each quarter close. In these meetings Colvin explained to the collectors that no credits were to be issued because sales were not doing well and Exodus needed to keep these transactions on the books in order to report the quarter.

171. CW10 specifically identified and described the following customer accounts as having false and/or premature revenue recognition:

(a) **Lycos, Inc.** - Lycos, Inc. consistently generated approximately $2 million per month in revenue throughout the Class Period. There were always credits owed to Lycos due to the fraudulent overbilling of the account. Further, installation charges were prematurely invoiced at least three months prior to the actual installation. CW10 estimates that at least 25%-50% of the Lycos accounts receivable during the Class Period was the result of fraudulent overbillings and known credits due to Lycos that had not been approved by defendant Dollahite or other executive management.

(b) **Yahoo.com** - Yahoo was the subject of substantial false billings, including premature invoicing for installation. The fraudulent billings also related to invoicing for excessive bandwidth and space that was not ordered or used. Substantial credits were owed to Yahoo during the Class Period.

(c) **Merrill Lynch** - The Merrill Lynch deal called for payment of $2 million per quarter. CW10 recalled that "right off the bat," Merrill Lynch was invoiced for approximately $800,000 through the false installation sheet/premature invoicing scheme described above. Due to the fraudulent invoices, by the end of the first quarter 2001, over $1 million in credits were owed to Merrill Lynch. These credits were not approved or issued until at least second quarter 2001.

(d) **CNA Insurance** - CNA was invoiced through the false installation sheet/premature invoicing scheme and was also the subject of excessive charges for bandwidth and IDC space. The fraudulent overcharges continued to occur throughout the Class Period.

(e) **BestBuy.com**- BestBuy.com was prematurely invoiced prior to installation. CW10 further recalls that "bandwidth was a mess" with this customer, as Exodus continuously invoiced BestBuy.com for amounts far in excess of bandwidth utilized. Large credits were owed to the BestBuy.com account throughout the Class Period, but authorization by defendant Dollahite or other executives did not occur until several quarters later.

(f) **Metropolitan Life** - False installation invoices were generated prematurely and recognized as revenue in first quarter 2001 on this account. CW10 further recalled issues between Exodus and MetLife over bandwidth and IDC space charges. A substantial portion of the MetLife accounts receivable balance throughout the Class Period was ultimately reversed by issuing credit to the customer. The credits were not issued until at least third quarter 2001.

(g) **Franklin Templeton** - This account was a "big mess" beginning when it first became a customer in 2000. This account was also subject to premature installation invoices. Additionally, Franklin Templeton was over-billed for IDC space and excessive professional services, as well as for services never performed. CW10 estimated that at least 50% of the revenue recognized and accounts receivable associated with the Franklin Templeton account were false and subject to credits.

(h) **Advertising.com** - Installation invoices were generated prematurely on this account. Also this high credit risk customer was approved by Hancock. *See* ¶¶177-178 for further discussion regarding customers that presented a high credit risk.

(i) **Akamai** - Exodus generated invoices for excessive bandwidth on this account and CW10 recalled that substantial credits were owed to this customer throughout the Class Period.

(j) **United HealthCare Services** - Although this was a creditworthy and good customer, Exodus fraudulently over-billed this account. CW10 estimates that by the end of second quarter 2001 as much as 50% of the accounts receivable associated with this account related to fraudulent invoices.

(k) **Microsoft** - There were heated disputes regarding Exodus' invoices to Microsoft. A portion of the problems were due to excessive charges for space and bandwidth. These problems were ongoing during the Class Period, and credits were issued in later 2001.

(l) **Inktomi** - Exodus and Inktomi announced Exodus' plan to deploy Inktomi's technology in its IDCs in December 1998. According to CW10, Inktomi also became a customer of Exodus in early 1999, at which time Exodus prematurely invoiced Inktomi for installation. The fraudulent invoicing on the Inktomi account continued throughout the Class Period. CW10 recalled that throughout the Class Period Exodus invoiced Inktomi for approximately $200,000 per month, but only 50% of the charges were real. Further, at quarter ends Exodus and Inktomi would swap invoices totaling approximately $500,000 - for no other reason than to fictitiously gross-up revenue.

172. Plaintiffs have obtained Exodus' internal "Top 30 as of 2/21/01" report from one of the Confidential Witnesses. The report identifies the then current list of the 30 Exodus customers with the highest accounts receivable balances. Further, the report contains "Comments re: Status." These comments document the status of collection and/or other pertinent comments. The following accounts appear on the "Top 30 as of 2/21/01" report and confirm the information received from CW10 as documented above:

(a) **Advertising.com**: Advertising.com appeared on the report with an outstanding accounts receivable balance of $1,536,897.77. The comments stated, "Disputes over SNI, bandwidth, billing where space was never in use."

(b) **CNA Insurance**: CNA Insurance appeared on the report with an outstanding accounts receivable balance of $2,646,495.92. The comments stated, "Most of the invoices are in dispute per A/P."

(c) **Franklin Templeton Companies**: Franklin Templeton Companies appeared on the report with an outstanding accounts receivable balance of $1,646,174.44. The comments stated, "Contract confusion concerning new or old contract with ***debooking issues***."[(4)]

173. Suzanne Colvin, Controller, specifically expressed concern over the past due Franklin Templeton account in an email dated February 22, 2001. The email stated:

> I am frightened to see Franklin Templeton back on this report - - and to notice the comment that is listed. Given the MASSIVE challenges we encountered last time with this account and how hard it was to sort out the billing issues, should you step in right away?

174. CW2 and CW5 also confirmed that invoicing and revenue recognition continued after a contract was cancelled. CW2 was part of the Collections Task Force, internally referred to as the Customer Care Center or "CCC." The CCC was established during first quarter 22001 to work customers with past due balances to determine if 1) past due charges were legitimate; and 2) if charges were legitimate, to arrive at mutually agreeable payment terms. Through CW2's work on the CCC it was apparent that revenues recorded during the Class Period were not "real."

175. CW3 also confirmed that in first quarter 2001 Exodus would book a service, record revenue, and then ultimately "debook" the transaction by issuing credit memos to customers in subsequent quarters.

176. Further, CW11 stated that by the fall of 2001, approximately 1,500 active customer accounts were formally cancelled by the Credit and Collections department because CCC collectors had determined that these customers had previously cancelled. Some cancellations had occurred as early as the fall of 2000. CW11 stated that approximately 40-50 % of revenue was recognized inappropriately during the first 6 months of 2001. Taking into account the $96 million bad debt reserve that Exodus reported at 6/30/01, this would equate to at least $171 million of fraudulent revenue recognized during the first six months of 2001. This fraudulent revenue represents 14% of the reported net loss for the 6 months ended 6/30/01.

177. CW12 confirmed the false installation practices as well as the continued invoicing and revenue recognition on cancelled contracts. CW12 further confirmed that at least 1,000 of the customers being

invoiced during the first 6 months of 2001 had previously cancelled and many others were owed credits that were pending approval.

178. Also, in an effort to hide this fraudulent revenue, Exodus employed a scheme to fictitiously record cash receipts so that it appeared as though customers were paying the invoices. *See* ¶192.

R. Exodus Recorded Revenue on Contracts Where Collectibility Was Not Reasonably Assured and Failed to Establish Adequate Reserves

179. It was common practice for Exodus to enter into contracts with customers that had limited capital resources, many of which were Internet companies on the verge of bankruptcy. Despite this known inability to pay, defendants Hancock, Mohamad, Dollahite, Case and Stoltz frequently approved deals with these customers in order to continue to report revenue growth throughout the Class Period. These transactions were in violation of GAAP and SEC rules as the collectibility was ***not*** reasonably assured. Recording revenues on transactions in which collectibility was an issue contributed to Exodus' deteriorating accounts receivable throughout the Class Period. 180. CW10 stated that prior to executing an agreement with a new customer, authorization had to be received.[(5)]

CW10 stated that Jeff Ploshay, had the authority to approve deals with customers that did not present a credit risk. However, many of the Internet and start-up customers were a high credit risk and required "upper management" authorization. Many of these companies had: limited cash; limited access to additional cash; limited, or poor credit history; limited number of references and products still in development. Despite these known risks, defendant's Hancock, Mohamad, Dollahite, Case and Stoltz authorized sales agreements with risky Internet and start-up companies. CW10 discussed the following examples of high risk contracts that required and received "upper management" approval:

(a) **Advertising.com** - Advertising.com was a typical dot-com customer that had poor credit and insufficient funds. This contract was approved by defendant Hancock. Advertising.com was also the subject of premature installation invoices.

(b) **Freerealtime.com** - Freerealtime.com became a customer of Exodus during 2000. CW10 performed the credit analysis and informed Ploshay that this company was a huge credit risk. The deal was "pushed through" by Hancock or other executives, and always presented a "hard collection." Further, Freerealtime also disputed invoices because it had been overcharged for bandwidth and prematurely charged for installation.

(c) **Business.com** - CW10 described Business.com as "the typical dot-com customer" in that it was an uncreditworthy customer which executive management approved and ultimately resulted in delayed or no payments. Further, Business.com was the subject of premature installation invoicing.

181. Additional examples of high risk customers approved by Hancock or Stoltz during 2000 are Buy.com and Beyond.com.

182. CW5 also disclosed that although Exodus had procedures for determining the creditworthiness of potential customers, defendant Hancock would frequently approve non-creditworthy customers in order to record revenues.

183. As an example, CW5 described one particular instance when services were shut down on a customer that owed approximately $700,000. Despite the delinquency and known inability to pay, defendants Hancock and Case ordered the customers' services to be "brought back up" immediately. Services were returned, monthly billing continued and collection was not made.

184. Notwithstanding the fact that Exodus recognized revenue in violation of GAAP by: (a) recording revenue prior to rendering services; (b) recording revenue on cancelled or non-renewed contracts; and (c) recording revenue on transactions in which collectibility was not probable, Exodus also violated GAAP by failing to establish sufficient reserves for its deteriorating accounts receivable. GAAP as set forth in FASB Statement of Financial Accounting Standards (SFAS) No. 5, Accounting for Contingencies, sets forth that an estimated loss shall be accrued by a charge to income if it is probable that an asset had been impaired and the amount can be reasonably estimated. *See* SFAS No. 5 ¶8. Further, collectibility of receivables is specifically listed as an example of a loss contingency. *See* SFAS No. 5 ¶4.

185. CW5 was responsible for generating bad debt reserve and revenue reserve reports. These reports were generated on a monthly basis and distributed by the 6th day of the following month. CW5 stated the March 2001 report reflected 40% of the overall accounts receivable as being uncollectible. This report was distributed to defendants Hancock, Case and Dollahite in early April, well before defendants filed the Company's first quarter 2001 Form 10-Q and within weeks of defendants filing the Company's 2000 Form 10-K. However, no additional reserves were established and no disclosures were made regarding the deteriorating accounts receivable balance in either of these SEC filings.

186. Exodus reported an accounts receivable reserve of $23.8 million or 12% of its gross accounts receivable balance as of 12/31/00 and $95.5 million or 26% of its gross accounts receivable balance as of 6/30/01. A 40% accounts receivable reserve would have required an additional charge of $56 million or 22% of the Company's reported net loss for the year-ended 12/31/00, or a an additional charge of $52 million as of 6/30/01.

S. Exodus' Barter Transactions

187. Another scheme devised by defendants was to improperly gross up revenues based on fictitious or over valued barter transactions.

188. GAAP, as set forth by APB 29, Accounting for Nonmonetary Transactions, concludes that, in general, accounting for nonmonetary transactions should be based on the fair values of the assets (or services) involved. *See* APB 29, ¶18. Further, APB 29 states "an enterprise that engages in one or more non-monetary transactions during a period should disclose in financial statements for the period the nature of the transactions, the basis of accounting for the assets transferred, and gains or losses recognized on transfers." *See* APB No. 29, ¶28.

189. Further, SEC Regulation S-K §229.303, requires management to describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. Failure to disclose non-monetary transactions violates this SEC regulation.

190. The AICPA in its guidance to auditors has identified barter transactions as a highly suspicious transaction. AICPA Practice Alert No. 95-1, Revenue Recognition Issues, discusses the possibility that client personnel may knowingly participate and assist in schemes designed to overstate revenue and conditions that can be indicative of improper and unusual revenue practices. AICPA Practice Alert No.

95-1 specifically lists ***barter transactions*** as an example of improper and unusual revenue transactions.(6)

191. Exodus entered into barter transactions for the sole purpose of grossing up revenue as the Company did not need and never intended to utilize software and other assets received as a result of these exchanges. These transactions violated GAAP and SEC rules as they were not based on fair values of assets or services exchanged and Exodus failed to disclose the existence of such transactions. Following are examples of this practice:

(a) CW1 stated that during the first quarter of 2001, Exodus entered into a barter transaction with a small Silicon Valley start-up, Innoventry. CW1 recalled that in return for an $800,000 MRC type transaction, Exodus "purchased" unneeded software licenses from Innoventry. This transaction was "debooked" in the second half of 2001.

(b) CW1 also described a barter transaction with a company named Niku. In this transaction the two companies agreed to write checks for approximately $417,000. Although Exodus invoiced Niku for "services rendered" during 4Q00, no services were ***ever*** performed. Further, the software licenses Niku was to provide Exodus related to a time management system. Exodus was in the process of implementing a different time management system and had no intention of utilizing the Niku license. This fictitious transaction was "debooked" in the second half of 2001.

(c) CW1 further explained that the fictitious barter transactions were extremely important to Exodus as there were no costs associated with these fictitious sales and the amounts "blow straight through to net income."

(d) Contrary to GAAP and SEC rules, Exodus improperly recognized revenue during the Class Period in conjunction with barter transactions and failed to disclose such transactions.

EXODUS' FRAUDULENT CASH ACCOUNTING

192. As a result of its improper revenue recognition practices, Exodus' accounts receivable balances deteriorated throughout the Class Period. In an attempt to conceal its fraudulent revenue recognition practices, Exodus recorded fictitious cash receipts to give the appearance that its accounts receivables were being paid. As described by CW1, this fraudulent practice was initiated at the direction of Suzanne Colvin, Controller, and consisted of contacting customers, including those with balances greater than 60 or 90 days past due, and inquiring if or when a check would be sent. Upon confirmation that "a check was in the mail," Exodus would record a fictitious entry to increase its cash and decrease its accounts receivable. Exodus' reporting of a fictitious cash balance is a violation of one of the most basic concepts of GAAP - Representational Faithfulness.(7) *See* FASCON No. 2, ¶¶63-71. Further, in addition to the misstatement of Exodus' financial statements, the recording of fictitious cash receipts also caused Exodus' calculated DSO to be artificially low. DSO indicates how quickly a company will collect cash from its sales activity and it is an important metric that Wall Street analysts frequently analyze when reporting on a company.

Fundamental GAAP Violations

193. Due to the accounting improprieties discussed above, the Company presented its financial statements in a manner which violated GAAP, including the following fundamental accounting principles:

(a) The principle that interim financial reporting should be based upon the same accounting principles and practices used to prepare annual financial statements was violated (APB No. 28, ¶10);

(b) The principle that financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions was violated (FASCON No. 1, ¶34);

(c) The principle that financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and effects of transactions, events and circumstances that change resources and claims to those resources was violated (FASCON No. 1, ¶40);

(d) The principle that financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it was violated. To the extent that management offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for accountability to prospective investors and to the public in general (FASCON No. 1, ¶50);

(e) The principle that financial reporting should provide information about an enterprise's financial performance during a period was violated. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance (FASCON No. 1, ¶42);

(f) The principle that financial reporting should be reliable in that it represents what it purports to represent was violated. That information should be reliable as well as relevant is a notion that is central to accounting (FASCON No. 2, ¶¶58-59);

(g) 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 was violated (FASCON No. 2, ¶79); and

(h) 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 was violated. The best way to avoid injury to investors is to try to ensure that what is reported represents what it purports to represent (FASCON No. 2, ¶¶95, 97).

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

SCIENTER

195. The combination of defendants' knowledge or deliberate recklessness, along with motive for committing the fraud, establishes scienter, as follows:

Knowledge

196. As set forth above, defendants had full knowledge of the improper revenue recognition practices and

the poor business condition of Exodus. Among other things, by participating in Monday morning executive meetings where the MRC issues, reserve issues and forecasting issues were brought up, defendants obtained knowledge of such issues. Defendants Hancock, Case and Dollahite also had direct knowledge of barter transactions, including those involving Oracle, Innoventry and SANrise. Defendants also received various reports, such as Exodus' P&L statements and reserve reports, that disclosed the Company's true financial conditions to which they were aware. Furthermore, Hancock was fully aware that Exodus was improperly recording revenue that had been canceled, because she was directly informed of such. Defendants were also aware that Exodus did not have sufficient funds to make its business plan because the capital plan showed that Exodus needed much more cash than it had to accomplish its plan.

Motive

197. **Desire to Profit from Insider Trading** - During the Class Period, almost all of the defendants engaged in insider trading, selling 1.4 million shares of Exodus stock for proceeds of over $72.5 million. These trades were made prior to the adverse disclosure by Exodus while the defendants were making positive statements about the Company. The following are the insider sales:

NAME	DATE	SHARES	PRICE	PROCEEDS
Hancock, Ellen (CEO and Chairman)	May 31, 2000	20,000	$72.87	$1,457,400
	Aug 30, 2000	66,638	$65.38	$4,356,792
	May 1, 2001	81,695	$9.83	$ 803,061
	May 2, 2001	145,580	$9.83	$1,431,051
	May 4, 2001	57,758	$9.83	$ 667,761
	Sub-total	**371,671**		**$8.72 million**
Case, Marshall (CFO and EVP of Finance)	Aug 31, 2000	200,000	$65.11-$66.31	$13.15 million
	Sub-total	**200,000**		**$13.15 million**
Wegner, Adam W. (EVP of Legal & Corp. Affairs)	April 26, 2000	10,000	$80.01	$ 800,100
	April 28, 2000	34,800	$85.00	$2,958,000
	Aug 31, 2000	114,996	$65.00-$66.00	$7.58 million
	May 2, 2001	29,834	$10.50	$ 313,257
	May 2, 2001	30,000	$10.00	$ 300,000
	sub-total	**219,630**		**$11.95 million**
Dollahite, Herbert (EVP of Customer Service, Support & Quality)	May 30, 2001	96,800	$7.88	$762,784.00
	sub-total	**96,800**		**$762,784.00**
Mohamad, Sam (EVP of Worldwide Sales)	April 25, 2000	5,000	$77.89	$ 348,450
	April 27, 2000	10,000	$73.75	$ 737,500
	April 28, 2000	10,000	$85.97	$ 859,700
	May 4, 2000	10,000	$87.70	$ 877,000

	May 5, 2000	10,000	$84.28	$ 842,800
	May 9, 2000	10,000	$79.37	$ 793,700
	Aug 31, 2000	192,971	$64.83-$66.50	$12.68 million
	sub-total	**247,971**		**$17.14 million**
Yeack, William R. (EVP of Managed Professional Services)	Aug 31, 2000	117,600	$64.91	$7.63 million
	sub-total	**117,600**		**$7.63 million**
Brown, Beverly (EVP of Marketing)	Aug 31, 2000	201,360	$64.75-$65.88	$13.15 million
	sub-total	**201,360**		**$13.15 million**
TOTAL		**1,455,032**		**$72.5 million**

198. These trades were suspicious in timing and amount. Defendants Hancock and Wegner's first sales of Exodus stock occurred just after the start of the Class Period (even though Hancock had been employed by Exodus since July 1998 and Wegner since October 1998), and they sold large amounts of Exodus stock just before some of the highly negative information was disclosed to the market on June 20, 2001. Similarly, Dollahite, who had been employed by Exodus since June 1998, made his first and only sale of Exodus stock just before this date. Further, when CFO Case sold his shares on August 31, 2000, he sold 100% of his holdings of Exodus stock.

199. In particular, Hancock's trades were so unusual that a July 9, 2001 article in *Barron's* entitled "Shareholders Are Exiting Exodus, Including CEO Hancock," commented on the massive insider sales by defendant Hancock at a suspicious time. The article stated:

> But what is a tad surprising, if not entirely disappointing, is that among the throngs of disenchanted stockholders running scared from the company's shares has been Exodus chief executive, Ellen Hancock. ***As the saw goes, actions speak louder than words, and Hancock has been dumping her holdings with the alacrity of a panicky momentum trader***.
>
> According to Thompson/First Call, Hancock sold or registered to sell more than 685,000 shares during the first half of May. (Some shares were held indirectly by a family member or trust). First Call estimates the potential proceeds of the unloading around $6.7 million. Some 285,000 shares were sold at 9.83. The trampled issues closed Friday under 2. ***A skipper is entitled to lighten her load when the vessel is sinking. But Hancock deep-sixed a large chunk of her holdings just weeks before the rest of us would learn that the company's second quarter was a shipwreck***.

200. **Desire to Obtain Financing** - Another reason why defendants were motivated to artificially inflate the stock price of the Company was in order to obtain a high credit rating and much needed financing. From the Company's inception, Exodus has financed its operations primarily through sales of stock, various debt and note offerings and working capital lines of credit. In order to continue to obtain such financing at favorable terms, defendants were motivated to falsify its financial performance, to make highly positive statements about the Company, and to artificially inflate its stock price. During the Class Period, defendants were able to complete a private offering, a secondary public offering and a public notes offering for proceeds of almost $2 billion. Disclosure of the Company's true facts would have greatly hindered the Company's ability to obtain financing, the life-blood of the Company. ***Desire to***

Continue the Appearance of Growth **-** From Exodus' inception as a public company, Exodus was billed as a fast growth Company, and its high stock price was dependent upon its phenomenal growth rate. During the Class Period, defendants engaged in a growth by acquisition strategy in order to sustain this growth rate and in order to meet Wall Street expectations. The failure to grow and to meet expectations would have jeopardized the funding much needed by the Company to continue its business, and would have hindered the Company's ability to attract and keep employees, whose compensation was linked in part to Exodus' stock price. Further, by continuing the appearance of growth, defendants were able to continue to enjoy their executive positions, high compensations, and prestige. ***Desire to Prevent Bankruptcy*** - Because unless Exodus was able to show growth and strength, it would have difficulty obtaining funding, in order to prevent Exodus from filing bankruptcy much sooner, defendants were motivated to engage in the fraud. Bankruptcy meant that defendants were likely to lose their positions, high compensations, and prestige. Further, Exodus' bankruptcy would have also affected their reputations and prospects for future positions with other companies.

PLAINTIFFS' CLASS ACTION ALLEGATIONS

201. Plaintiffs bring this action as a class action pursuant to Rule 23(a) and (b)(3) of the Federal Rules of Civil Procedure on behalf of a class consisting of all persons and entities who purchased or otherwise acquired Exodus securities from April 20, 2000 through and including September 25, 2001, inclusive, and who were damaged thereby. Excluded from the Class are defendants, officers and directors of the Company, members of their immediate families, and their legal representatives, heirs, successors or assigns and any entity in which defendants have or had a controlling interest.

202. During the Class Period, Exodus securities were traded on an efficient and developed securities market. Thousands of brokers nationwide have access to trading information about Exodus through the system. Within minutes of any transaction taking place, this system displays the most recent trades and prices.

203. The members of the class are so numerous that joinder of all members is impracticable. While the exact number of class members is unknown to plaintiffs at this time and can only be ascertained through appropriate discovery, plaintiffs believe that there are thousands of members of the class. During the Class Period, Exodus had over 550 million shares of common stock outstanding and actively traded on the NASDAQ National Market, an efficient market, under the ticker symbol "EXDS."

204. Plaintiffs' claims are typical of the claims of the members of the class as all members of the class are similarly affected by defendants' wrongful conduct in violation of federal law that is complained of herein.

205. Plaintiffs will fairly and adequately protect the interests of the members of the class and have retained counsel competent and experienced in class and securities litigation. Plaintiffs have no interests that are adverse or antagonistic to those of the class.

206. A class action is superior to other available methods for the fair and efficient adjudication of this controversy. Because the damages suffered by many individual class members may be relatively small, the expense and burden of individual litigation make it virtually impossible for the class members to individually seek redress for the wrongful conduct alleged herein.

207. Common questions of law and fact exist as to all members of the class and predominate over any questions affecting solely individual members of the class. Among the questions of law and fact common to the class are:

(a) whether the federal securities laws were violated by defendants' acts as alleged herein;

(b) whether defendants participated in and pursued the common course of conduct complained of herein;

(c) whether documents, press releases and other statements disseminated to the investing public during the Class Period misrepresented the business condition of Exodus;

(d) whether defendants failed to correct prior statements when subsequent events rendered those prior statements untrue or inaccurate;

(e) whether defendants acted willfully or recklessly in misrepresenting and/or omitting to state material facts;

(f) whether the market price of Exodus' securities during the Class Period was artificially inflated due to the misrepresentations and/or non-disclosures complained of herein; and

(g) whether the members of the class have sustained damages, and, if so, what is the proper measure thereof.

208. Plaintiffs will rely, in part, upon the presumption of reliance established by the fraud-on-the-market doctrine in that:

(a) defendants made public misrepresentations or omitted material facts during the Class Period, as alleged herein;

(b) the misrepresentations and/or omissions were material;

(c) Exodus' securities were traded in an efficient market;

(d) the misrepresentations and/or omissions alleged tended to induce reasonable investors to misjudge the value of Exodus shares; and

(e) plaintiffs and members of the class acquired their securities between the time defendants made the misrepresentations and/or omissions and the time the truth was revealed, without knowledge of the falsity of the misrepresentations.

COUNT I

(Violations of Section 10(b) of the Exchange Act
and Rule 10-5 Promulgated Thereunder)

209. Plaintiffs incorporate by reference the above paragraphs as if set forth fully herein.

210. During the Class Period, the defendants, and each of them, carried out a plan, scheme and course of conduct which was intended to and, throughout the Class Period, did: (i) deceive the investing public, including plaintiffs and the other class members, as alleged herein; (ii) artificially inflate and maintain the market price of Exodus; and (iii) cause plaintiffs and other members of the class to purchase Exodus

securities at inflated prices. In furtherance of this unlawful scheme, plan and course of conduct, defendants, and each of them, took the actions set forth herein.

211. Defendants (a) employed devices, schemes, and artifices to defraud; (b) made untrue statements of material fact and/or omitted to state material facts necessary to make the statements not misleading; and (c) engaged in acts, practices, and a course of business which operated as a fraud and deceit upon the purchasers of the Company's securities in an effort to maintain artificially high market prices for Exodus securities in violation of §10(b) of the Exchange Act and Rule 10b-5.

212. The statements made by defendants during the Class Period were materially false and misleading because at the time they were made, the Company and persons acting as corporate officers knew or were consciously reckless in failing to disclose the matters set forth herein.

213. In ignorance of the artificially high market prices of Exodus' publicly traded securities, and relying directly on defendants or indirectly on the false and misleading statements made by defendants, upon the integrity of the market in which the securities trade, on the integrity of the regulatory process and the truth of representations made to appropriate agencies throughout the Class Period and/or on the absence of material adverse information that was known to defendants but not disclosed in public statements by defendants during the Class Period, plaintiffs and the other members of the class acquired Exodus securities during the Class Period at artificially high prices and were damaged thereby.

214. Had plaintiffs and the other members of the class and the marketplace known of the true financial condition and business prospects of Exodus which were not disclosed by defendants, plaintiffs and other members of the class would not have purchased or otherwise acquired their Exodus securities during the Class Period, or would have not done so at the artificially inflated prices which they paid. Hence, plaintiffs and the class were damaged by defendants' violations of §10(b) and Rule 10b-5.

COUNT II

(Violation of §20(a) of the Exchange Act Against the Individual Defendants)

215. Plaintiffs incorporate by reference the above paragraphs as if set forth fully herein. This Count is asserted against the Individual Defendants.

216. The Individual Defendants acted as controlling persons of Exodus within the meaning of §20(a) of the Exchange Act as alleged herein. By reasons of their executive and managerial positions with Exodus, the Individual Defendants had the power and authority to cause the Company to engage in the wrongful conduct complained of herein.

217. By reasons of the aforementioned wrongful conduct, the Individual Defendants are liable pursuant to §20(a) of the Exchange Act. As a direct and proximate result of their wrongful conduct, plaintiffs and the other members of the class suffered damages in connection with purchasing the Company's securities during the Class Period.

COUNT III

(Violation of Sections 11 and 15 of the Securities Act Against Hancock, Goldman, Merrill Lynch, Morgan Stanley and J. P. Morgan)

218. Plaintiffs assert claims for violations of §11 of the Securities Act, 15 U.S.C. §77k, against defendants Hancock, Goldman, Merrill Lynch, Morgan Stanley and J. P. Morgan on behalf of investors who purchased securities pursuant to a registration statement filed with the SEC during the Class Period, including but not limited to the February 6, 2001 stock and note offering. A Claim is also asserted against defendant Hancock for violation of §15 of the Securities Act, 15 U.S.C. §77o, by virtue of her direct and indirect control and domination of Exodus.

219. Exodus issued the securities registered by the Registration Statement. The defendants named in this Claim either signed the Registration Statement or were a director of the issuer at the time of the filing of the Registration Statement.

PRAYER

WHEREFORE, plaintiffs pray for relief and judgment, as follows:

1. Determining that this action is a proper class action, certifying plaintiffs as class representatives under Rule 23 of the Federal Rules of Civil Procedure and plaintiffs' counsel as class counsel;

2. Awarding compensatory damages in favor of plaintiffs and the other class members against all defendants, jointly and severally, for all damages sustained as a result of defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;

3. Awarding plaintiffs and the class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

4. Such other and further relief as the Court may deem just and proper.

JURY DEMAND

Plaintiffs hereby demand a trial by jury.

DATED: July 11, 2002

MILBERG WEISS BERSHAD
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REED R. KATHREIN
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Co-Lead Counsel for Plaintiffs

DECLARATION OF SERVICE BY FACSIMILE

PURSUANT TO NORTHERN DISTRICT LOCAL RULE 23-2(c)(2)

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and a resident of the County of San Francisco, over the age of 18 years, and not a party to or interest in the within action; that declarant's business address is 100 Pine Street, 26th Floor, San Francisco, California 94111.

2. That on July 11, 2002, declarant served by facsimile the FIRST AMENDED CONSOLIDATED CLASS ACTION COMPLAINT FOR VIOLATION OF THE FEDERAL SECURITIES LAWS to the parties listed on the attached Service List and this document was forwarded to the following designated Internet site at:

http://securities.milberg.com

3. That there is a regular communication by facsimile between the place of origin and the places so addressed.

I declare under penalty of perjury that the foregoing is true and correct. Executed this 11th day of July, 2002, at San Francisco, California.

____
Cynthia Sheppard

1. FASCON No. 5 states, "revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues." *See* FASCON No. 5, ¶83 (b).

2. Revenue was delineated as MRC and Non-Recurring Cost ("NRC"). An MRC deal typically covered a 12 month period while an NRC deal covered the initial costs of installation and implementation . Structuring a deal as an MRC provided the customer with a longer period of time to pay for the services. As a result, many customers that did not have the capital readily available for a lump sum payment entered into deals structured as MRC deals.

3. Several CWs confirmed that revenue was recorded at the time invoices were generated from the billing system.

4. According to CW1, Exodus employees used the term "debook" to refer to credit memos issued or reserves established for revenue that had been inappropriately recorded in a prior period.

5. CW10 stated that beginning in early 2000, a credit analysis form was created to formalize and document a customer's financial status. The form contained a customer's bank account information and balances, venture capital firms and committed investments, as well as vendor references. An authorizing signature was required on the credit analysis form before a deal could be entered into.

6. Additionally, AICPA Practice Alert No. 98-3, Revenue Recognition Issues, was issued in November 1998 to remind auditors of certain factors or conditions that can be indicative of increased audit risk of improper, aggressive or unusual revenue recognition practices. Once again, this alert specifically lists ***barter transactions*** as an issue requiring special consideration.

7. FASCON No. 2 defines Representational Faithfulness as follows: "Correspondence or agreement between a measure or description and the phenomenon that it purports to represent (sometimes called validity)." *See* FASCON No. 2 Glossary of Terms.