EXHIBIT A
TO NOTICE OF LODGMENT

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UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

WESTERN DIVISION

In re HOMESTORE.COM, INC. SECURITIES LITIGATION	Master File No. 01-CV-11115 RSWL (CWx)
	CLASS ACTION
This Document Relates to:	**[PROPOSED] THIRD AMENDED CONSOLIDATED COMPLAINT FOR VIOLATIONS OF FEDERAL SECURITIES LAWS**
ALL ACTIONS.	**DEMAND FOR JURY TRIAL**

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I. INTRODUCTION

1. This complaint is filed pursuant to the standard articulated in the United States Supreme Court decision in *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.,* 128 S.Ct. 761 (2007) and the Ninth Circuit's subsequent order in *Simpson v. Homestore.com, Inc.,* 519 F.3d 1041 (9th Cir. 2008). This case is a securities class action arising from a scheme to defraud investors in Homestore.com ("Homestore") common stock. The Homestore financial fraud was based on a simple concept: Since the company was not able to meet the expectations of Wall Street through the production of legitimate revenues, Homestore resorted to "buying revenues." In order to do so, Homestore falsified its financial statements in violation of accounting and financial reporting rules. The incentive of Defendant Stuart Wolff ("Wolff"), Homestore's founder and CEO, to participate in this fraud was also simple: To cash in through stock options and insider trading. The incentive of Defendant Cendant Corporation ("Cendant") was the same: To make sure its investment in Homestore was protected by keeping the stock price high. These fraudulent transactions resulted in Homestore restating reported financial statements in the amount of <u>$192,598,000</u> for the years 2000 and 2001.

2. The top two executives at Homestore, founder Stuart H. Wolff, and his first employee Peter B. Tafeen ("Tafeen"), created a corporate culture premised on the absolute requirement to meet Homestore's projected revenue target known as the "bogie" or the "plug,"and never disappointing the analysts. The company became obsessed with hitting the "bogie" at all costs, even to the point of engaging in fraudulent transactions with other companies, including Cendant. Wolff was a primary violator who signed false and misleading documents filed with the Securities and Exchange Commission and made false and misleading statements to the public.

3. Homestore and Wolff undertook this financial fraud with the primary participation and knowledge of Defendants Cendant Corporation ("Cendant") and Richard A. Smith ("Smith"), the Chairman and CEO of Cendant's Real Estate Division. Homestore was a company built on alliances with the biggest names in the real estate and Internet industries. Cendant was a critical factor behind Homestore's rapid ascendancy into the highest ranks of Wall Street's Internet darling companies. Cendant had a huge financial stake in Homestore and one voting seat on the Board of Directors occupied by Smith. Smith wore two hats and operated under an irreconcilable conflict of interest throughout his tenure as a Homestore director.

4. Within the corporate ranks of Cendant, top executives were motivated to make their own department's bottom line look healthy. These executives created deals with Tafeen and they developed a relationship with Cendant to engage in transactions which allowed Homestore to make the "bogie" when Homestore was short. Smith was the primary participant in this financial scheme.

5. Consistent with the standard articulated in *Stoneridge*, Cendant and Smith are liable under § 10(b) because they committed primary violations. Cendant and Smith engaged in deceptive acts which were communicated to the public and made false and/or misleading public statements that resulted in an increase in the value of Homestore stock, which the investing public relied upon, and these statements were one substantial reason Homestore had to restate its financials. Although Cendant and Smith made many statements about the Move.com deal, neither ever disclosed that Cendant funded its Real Estate Technology Trust ("RETT") with $95 million as a *quid pro quo* for Homestore agreeing to acquire Move.com. Cendant and Homestore failed to fully disclose that both companies engaged in related party transactions through RETT, or the amount of revenue involved in these transactions, both of which must be disclosed in SEC filings and financial statements pursuant to Rule 4-08(K) of Regulation

S-X, 17 C.F.R. § 210.4-08(K). The failure to disclose made the representations materially misleading and caused the stock to increase 31%. In several SEC filings, Cendant wrote off the $95 million as an "unusual charge" regarding an "independent technology trust" which was misleading because it failed to disclose that the money was dedicated to providing Homestore with artificial revenues, that the contribution was contingent upon the completion of the Move.com deal, or that all deals between Homestore and RETT went through Cendant. According to Plaintiff's confidential sources, Homestore did not want to disclose the amount of revenue coming from Cendant due to the Move.com deal because it did not want to reveal its heavy reliance on Cendant as a source of revenue. Since Cendant acquired a 20% ownership stake in Homestore from the Move.com deal, Cendant also had an incentive to hide these facts because it wanted Homestore's stock price to remain high. Cendant continued to make incomplete and misleading statements about RETT and its connection to Homestore's financial condition throughout the Class Period.

6. In an October 27, 2000 press release, Homestore and Cendant jointly announced that Homestore was purchasing Move.com, and Smith, representing Cendant, made misrepresentations about the nature of the transaction. Later that same day during an investor conference call and webcast to discuss the deal, Smith, speaking on behalf of Cendant, misrepresented and failed to state the real reasons for the Move.com deal, despite having given other purported reasons for the deal. In fact, Homestore and Cendant knew that Move.com was the false deal to hide the RETT deal, which was the material transaction allowing Cendant to provide Homestore with $95 million in revenues. Cendant, Smith and Homestore knew this funding was desperately needed to artificially inflate Homestore stock. Cendant, Smith and Homestore knew that if the true facts were revealed, Homestore's stock would not increase. Without this disclosure, Homestore's stock increased 31% that day.

7. Smith, in conflicting roles as a Cendant executive and Homestore director, knew that other illegitimate transactions between the companies – the Preferred Alliance Agreements – and the voiding of them right before the filing of Homestore's 2001 third quarter 10-Q filing, created a reportable condition under Item 303 of Regulation S-K, 17 C.F.R. § 229.303, that was not disclosed to the public or the SEC at the time the 10-Q was filed. Homestore ultimately restated $14.64 million in 2001 revenues from the Preferred Alliance Agreements.

8. This action is brought by the California Teachers' Retirement System ("CalSTRS"), the Court appointed Lead Plaintiff in this securities class action. CalSTRS' participant members include several hundred thousand teachers throughout California whose retirement funds are administered and invested by CalSTRS.

9. Portions of this complaint, including the descriptions of the specific transactions at the heart of the fraud, are based on information obtained from confidential sources with personal knowledge of how the fraud was accomplished and the nature of Defendants' participation therein. In addition, three of the top executives in the Finance Department of Homestore, Giesecke, Shew and DeSimone, as well as other employees, have pled guilty to federal charges of securities fraud. The Information succinctly describes how the criminal conspiracy was accomplished:

> **"In order to achieve and attempt to achieve the goals of the scheme, defendants GIESECKE and SHEW, high-ranking corporate officers at Homestore, and others, caused Homestore to engage in a complicated series of 'round-trip' transactions whereby Homestore entered into agreements with various intermediaries to facilitate the circular flow of money from Homestore to the various intermediaries and then back to Homestore. These 'round-trip' transactions and the accompanying circular flow of money enabled Homestore to recognize its own cash as revenue in violation of GAAP. These illegal arrangements allowed Homestore to fraudulently inflate its revenue by essentially buying that revenue in violation of GAAP."**

See attached Exhibit A. These actions artificially inflated Homestore's revenues in furtherance of a scheme to defraud investors.

II. JURISDICTION AND VENUE

10. Federal subject matter jurisdiction exists pursuant to 28 U.S.C. §§ 1331 and 1337 and § 27 of the Exchange Act, 15 U.S.C. § 78a(a), and § 22 of the Securities Act 15 U.S.C. § 77(v). The claims asserted herein arise under and pursuant to §§ 10(b) and 20(a) of the Securities and Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b) and 78t(a), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder by the Securities and Exchange Commission ("SEC").

11. Venue is appropriate in the Central District of California pursuant to § 27 of the Exchange Act and 28 U.S.C. § 1391(b). Homestore has its principal place of business in Westlake Village, California and many of the acts alleged herein, including preparation and dissemination of the misleading statements to the investing public, occurred in substantial part in this District.

12. The Defendants, directly and/or indirectly, used the means and instrumentalities of interstate commerce, the United States mails, and the facilities of the national securities markets in connection with the acts, conduct, and other wrongs complained of herein.

III. THE PARTIES

A. PLAINTIFF

13. Plaintiff, the **California State Teachers' Retirement System** ("CalSTRS"), is the second largest public pension fund in the United States. CalSTRS administers retirement, disability and survivor benefits for California's public school educators in grades kindergarten through community college. CalSTRS serves approximately 686,855 members and benefit recipients. CalSTRS is administered by a 12-member Retirement Board and employs 540 employees. CalSTRS purchased 431,123 total shares of Homestore common stock

from May 4, 2000 to December 21, 2001, and invested a total of $13,361,336.03. CalSTRS suffered out of pocket losses on its investments in Homestore common stock of over $9 million.

14. On March 25, 2002, the Court appointed CalSTRS as Lead Plaintiff.

15. CalSTRS and members of the Class purchased Homestore stock in the open market, unaware that Defendants' statements and omissions regarding the stock and inflated financial results misrepresented Homestore's revenues and caused Homestore's stock price to be artificially inflated. Plaintiff and the Class relied upon Defendants' statements and omissions in Homestore and Cendant's public reports, press releases, and SEC filings and Smith's public statements when they purchased Homestore common stock and were thus injured by the Defendants' actions. Plaintiff and the Class further relied on the integrity of the market for Homestore securities and the fact that Homestore common stock was fairly priced.

B. DEFENDANTS

1. Cendant Corporation

16. Defendant **Cendant Corporation** ("Cendant") is a massive conglomerate with holdings in real estate, travel and vehicle rentals. At all relevant times, Cendant was Cendant Corporation and will be referred to as such throughout this complaint. However, in 2006 Cendant split itself into four parts: Realogy Corporation, made up of its former real estate services businesses; Wyndham Worldwide, made up of its resorts and hospitality services; Travelport, made up of its former travel distribution services businesses; and Avis Budget Group, made up of vehicle rental businesses. Its fiscal year 2000 profits were $1.5 billion based upon $3.9 billion in revenues. According to its website: "Cendant's Real Estate Division is the leader in the world's largest industry, with affiliates responsible for more than one out of every four homes sold or purchased in the U.S." Cendant also runs one of the country's largest retail mortgage originators,

the leading relocation services company, and franchises a leading commercial real estate brokerage system. Its real estate franchises include CENTURY 21, Coldwell Banker, Coldwell Banker Commercial, and ERA. Its hospitality segment caters to the mid-economy market and Cendant operates such hotels as the Days Inn, Ramada and Howard Johnson. One of its vehicle franchises is Avis. In August of 2002, Cendant announced that it would acquire Budget Group, Inc.

17. As alleged herein and more specifically detailed below, Cendant, through its authorized agents including Richard Smith, engaged in deceptive conduct communicated to the public and made material misrepresentations and omissions regarding the funding of and purposes of RETT and other transactions. Despite referring to a "unusual charge" regarding an "independent technology trust" in various SEC filings, Cendant never publicly disclosed in any of its public statements about RETT that it funded the RETT with $95 million in a *quid pro quo* for Homestore agreeing to acquire Move.com or the related transactions. According to former Homestore executive Joseph Shew, both Cendant and Homestore knew Cendant wanted to keep Move.com off of its income statement because it was a drag on Cendant's financial condition. Homestore would not have agreed to the Move.com acquisition without the guarantee of $80 million in revenue from the RETT in this related party transaction. In filings with the SEC, Cendant stated that the purpose of establishing RETT was to acquire technology on behalf of Cendant, but failed to disclose that the real purpose of the $95 million contribution to RETT was to fraudulently create revenue for Homestore. At the time RETT was funded, there were no specific deals in place regarding the products and services that Homestore would purchase. Moreover, although RETT and Cendant were related parties, Cendant did not disclose the related party transactions though RETT as SEC rules require. Shew testified in *U.S.A. v. Wolff* (CR 05-0398 PA (C.D. Cal.)) that Homestore had an **"incestuous" relationship** with Cendant because, *inter alia,* of Cendant's Richard A. Smith being a voting

member of Homestore's board of directors and Cendant's 20% ownership of Homestore stock. Accordingly, Tafeen understood Cendant and RETT to be the same entity. Independent of Homestore's fraudulent accounting, Cendant misrepresented the real reasons for the Move.com and RETT transactions and the related-party nature of those transactions. Thus, investors relied upon Cendant's statements and conduct in their decision to purchase Homestore stock, which statements also inflated the price of Homestore stock, and as a direct result suffered damages when the fraud was revealed.

2. <u>Richard A. Smith</u>

18. Defendant **Richard A. Smith** ("Smith") has been Chairman and Chief Executive Officer of Cendant's Real Estate Division since December 1997. Smith was President of the Real Estate Division for Cendant (then known as HFS Inc.) from October 1996 to December 1997 and Executive Vice President of Operations for HFS from February 1992 to October 1996. Smith was once a Director of NRT Incorporated. In 2001, as part of Cendant acquiring a large stake in Homestore through Homestore's acquisition of Cendant's Move.com, Smith became a voting member of Homestore's Board of Directors. At all times, Smith was an authorized agent of Cendant and his acts, statements and omissions alleged herein were done in the course and scope of his employment with Cendant.

19. Defendant Richard A. Smith made false and/or misleading statements regarding the relationship between Homestore and Cendant in a scheme to defraud investors. As alleged herein and more specifically detailed below, after a joint press release by Homestore and Cendant on October 27, 2000, which included a misrepresentation by Smith about the Move.com acquisition, Homestore's stock increased 31%. On Cendant's behalf, Smith arranged improper barter transactions – the Preferred Alliance Agreements – between Homestore and Cendant during the second quarter of 2001. These transactions artificially inflated Homestore's revenues. In November 2001, while occupying conflicting positions as a Cendant

executive and Homestore board member, Smith played a key role in the rescission of the unauthorized Preferred Alliance Agreements, which Tafeen had entered into on Homestore's behalf, and in concealing their existence from the Homestore board. If the agreements had not been rescinded, Homestore would have had to publicly restate its 2001 third quarter results even earlier than it did because it would not have been able to recognize revenues from its third quarter deals with RETT. Smith agreed to rescind the Preferred Alliance Agreements so that the contingent nature of the RETT and Move.com transactions, which Cendant omitted to disclose in its earlier SEC filings regarding these transactions, would not be revealed and so that Homestore could artificially inflate its revenues for the third quarter of 2001. Smith knew that these illegitimate agreements, and the voiding of them right before the filing of Homestore's third quarter 10-Q was released on November 14, 2001, presented a material risk that Cendant, Smith and Homestore had created a reportable condition under Item 303 of Regulation S-K, 17 C.F.R. § 229.303, that was not disclosed to the public or the SEC at the time the 10-Q was released. Thus, investors relied upon Smith's statements, omissions, and conduct in their decision to purchase Homestore stock.

3. <u>Stuart H. Wolff</u>

20. Defendant **Stuart H. Wolff** ("Wolff") joined Homestore in November 1996 as Chairman and Chief Executive Officer, a position he continuously held until he was reassigned as an employee and Director in January 2002. In August 1998, Wolff exercised options to acquire shares of Homestore's common stock in exchange for a Promissory Note. In April 1999, Wolff again exercised options to acquire shares of Homestore's common stock in exchange for Promissory Notes due to Homestore. For the year 2000, Wolff was paid $487,115 in salary and bonuses and was given 400,000 stock options. For the year 2001, Wolff was paid $240,097 in salary and was given 900,000 stock options. During the Class Period, Wolff sold 693,600 of his shares for a total of $33,763,389.75 in insider trading

proceeds. Additionally, Wolff signed every financial statement issued by Homestore during the Class Period, including every Form 10-Q and 10-K financial statement of Homestore for the year 2000 and all Form 10-Qs for the first three quarters of 2001.

21. In 2006, Wolff was convicted after a jury trial of 18 counts of securities fraud related to the Homestore fraudulent scheme. Wolff appealed to the Ninth Circuit Court of Appeals, which reversed and vacated his conviction on the sole grounds that the trial judge should have recused himself because he owned AOL stock.

22. As herein alleged and more specifically detailed below, Defendant Wolff engaged in deceptive conduct that artificially boosted Homestore's revenues in a scheme to defraud investors. Wolff's deceptive conduct included his knowledge and participation in transactions with Cendant, America Online ("AOL"), and others that fraudulently produced a round-trip flow of money in which Homestore recognized its own cash as revenue. In June and July 2001, Wolff wrote many e-mails to Former Defendant David Colburn and others at AOL regarding a dispute over AOL's payments to Homestore. On June 29 and 30, 2001, Wolff wrote Colburn and stated Homestore's position that AOL owed Homestore $2 million for the second quarter round-trip deal. According to Tafeen, in July 2001 Wolff asked AOL "to alter payments to Homestore so that Homestore could falsely claim additional revenue from the roundtrip deals for the quarter that ended on June 30, 2001." Wolff also participated with Former Defendant Tafeen, among others, in Homestore's efforts to conceal the scheme from the company's auditors. Wolff misled investors and analysts about Homestore's financial condition. In *Wolff*, John Giesecke testified that Wolff reviewed and authorized a September 6, 2001 press release reaffirming guidance of Homestore revenues of $134 million for the third quarter of 2001, despite knowing that there was no basis for reaffirming guidance at that level of revenues.

Wolff authorized press releases in October and November 2001 that falsely blamed the September 11, 2001 attacks for Homestore's poor financial performance. During the course of this deceptive conduct, Wolff obtained over $13 million in proceeds from exercising stock options in Homestore.

C. UNNAMED PARTICIPANTS

23. Numerous individuals and entities participated actively during the course of and in furtherance of the conspiracy to recognize false revenues for Homestore and to conceal such information from the public. The admitted facts by persons involved in the scheme demonstrate that there was a conspiracy and that many acts were done in the course of and in furtherance of the conspiracy by statements, conduct, and intent to defraud. The individuals and entities acted in concert by forming joint ventures and by acting as agents for principals, in order to advance the objectives of the conspiracy to increase false revenues for each of the participants. The acts were intended to promote the conspiratorial objectives and the conspiracy will be shown by a preponderance of the evidence. *U.S. v. Peralta*, 941 F.2d 1003 (9th Cir. 1991).

IV. CLASS ACTION ALLEGATIONS

24. Pursuant to Rule 23(a) and (b)(3) of the Federal Rules of Civil Procedure, Plaintiff brings this lawsuit on behalf of itself and a Class of persons and entities (the "Class") who purchased Homestore stock from January 1, 2000 through December 21, 2001 (the "Class Period"), inclusive. Excluded from the Class are Homestore and its subsidiaries, successors, predecessors, present and former officers and directors, and the Defendants and members of their immediate families, any person, firm, trust, corporation, officer, director or other individual or entity in which any Defendant has a controlling interest or which is affiliated with any of the Defendants, and any legal representatives, agents, affiliates, heirs, successors-in-interest or assigns of any excluded party.

25. This action was certified as a class action on September 29, 2003, because it meets Rule 23 requirements for numerosity, commonality, typicality, and superiority.

26. In reaching this conclusion, the Court analyzed whether the Plaintiff Class is entitled to the presumption of reliance based on the fraud on the market theory laid out by the Supreme Court in *Basic v. Levinson,* 485 U.S. 224 (1986). After analyzing the factors laid out in *Cammer v. Bloom,* 711 F. Supp. 1264, 1286-1287 (D.N.J. 1989) to be considered in determining whether the market for a security is efficient, the Court determined that the market for Homestore stock is "efficient, open, developed and impersonal. This is clearly a market that was envisioned in *Basic*, and the Plaintiff Class is therefore entitled to the presumption of reliance set forth by the Supreme Court." *See* Order Granting Class Certification at 9, filed September 29, 2003.

27. The following are questions of law and fact, common to the Class, which predominate over questions affecting individual members:

(a) Whether Defendants' acts as alleged herein violated federal securities laws;

(b) Whether Defendants engaged in the common course of conduct complained of herein;

(c) Whether disseminated documents, SEC filings, press releases and other statements, to the investing public and Homestore stockholders during the Class Period, misrepresented material facts about Homestore's operations, financial condition, and earnings;

(d) Whether Defendants' misrepresentations and failure to correct those misrepresentations complained of herein caused Homestore stock to be artificially inflated during the Class Period;

(e) The extent to which the members of the Class have sustained damages and the proper measure of those damages.

28. Plaintiff's claims are typical of those asserted by the other Class members and Plaintiff's interests are not adverse or antagonistic to the interests of the Class. Both the Plaintiff and Class members claim that Defendants violated

Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, as well as Section 20(a) of the Exchange Act.

29. Plaintiff will vigorously prosecute this action, and has retained competent counsel, Cotchett, Pitre & McCarthy, previously approved by this Court as lead counsel. Hence, Plaintiff is an adequate representative for the Class and will represent their interests fairly and adequately. Plaintiff does not anticipate any problem with managing this litigation as a class action.

30. The class mechanism is an efficient and fair method for adjudicating this action and is superior to other methods. The size of the Class would make other methods impracticable and without use of the class mechanism, many individual Class members might not be able to afford to prosecute their individual claims.

V. DEFENDANTS' WRONGFUL CONDUCT

A. SUMMARY OF SCHEME TO DEFRAUD THE INVESTING PUBLIC

1. The Genesis of Homestore

31. In 1996, Defendant Stuart H. Wolff started Homestore's predecessor, Realtor.com, which listed real estate on the Internet. Wolff's first major hire was Peter Tafeen, who became the "Prince of Deals." As with all Internet companies of the 1990's, Wolff and Tafeen knew that in order to become successful, Homestore would have to show revenue growth at least consistent with other Internet companies.

32. After Homestore went public in August of 1999, the need to generate and maintain revenue growth intensified. Wolff, Tafeen, and others devised and implemented a scheme to fraudulently create the illusion of revenues and/or engage in a course of business which operated as a fraud and/or deceit through: (1) barter transactions, (2) revenue buying and, (3) round-tripping transactions. Homestore, through fraudulent devices committed by Defendants, and each of

them, used these transactions to perpetuate the illusion of revenue growth to meet or exceed its quarterly revenue projections, or to "make the bogie," and thereby maintain and/or inflate its stock price. As known by the participants, there was no business need for the products and services Homestore acquired and the price of the goods and services were inflated. Instead, Homestore's purchases were designed to start the process of generating revenue through round-trip deals.

33. According to Joseph J. Shew, Jeff Kalina and John D. DeSimone, who personally participated in these transactions and have direct knowledge of their circumstances, Homestore undertook revenue generating transactions that were of "low quality" and presented more than acceptable risk in order to ensure increased revenues. These witnesses describe low quality transactions as those that have little or no long-term strategic benefit to Homestore. These witnesses recall, based upon personal knowledge, that these low quality revenue deals evolved into Homestore's outright fraudulent conduct of buying revenue in order to meet Wall Street's earnings expectations.

34. In order to determine the amount of "revenue" that had to be created in a given quarter, Homestore's executives monitored the company's revenue progress on computerized "Risk & Opportunity" ("R&O") sheets. The R&Os went through continual change right up to the end of each quarter, and were used to gauge how to "plug" any shortfall in the revenue target. The R&O sheets were also used to determine the quality (or lack thereof) of revenues. Homestore and its executives together with others rushed to generate revenues if it looked like the "bogie" would not be reached.

2. <u>Barter Transactions</u>

35. Historically, Internet companies engaged in transactions with each other in which they exchanged, or "bartered" rights to place advertising on each others' websites. Barter transactions could involve an exchange of services, cash,

or a combination of cash, equipment and/or services. From its inception, Homestore engaged in barter transactions with other companies.

36. In 1998, for example, Homestore and AOL Time Warner, Inc. ("AOL"), entered into a conventional barter transaction. Homestore paid AOL $20 million in cash and gave AOL 1.5 million warrants at various guaranteed prices in return for Homestore's right to be the exclusive online realtor for AOL. Homestore was able to recognize the revenue and AOL became an important partner in Homestore's scheme to generate revenue.

37. Government regulators and the accounting industry were concerned about whether companies were consistently reporting revenue for barter transactions. In November 1999 and January 2000, the Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board ("FASB"), issued EITF 99-17 in response to these concerns. In essence, the new accounting standard prohibits a company from reporting gross revenue from a barter transaction and requires the recognition of expenses. Before these new accounting standards took effect, Homestore's auditor, PricewaterhouseCoopers ("PWC"), gave seminars at Homestore's offices and thereafter tutored Wolff and others on applicable accounting standards.

38. In contravention of these new accounting standards, Wolff and others at Homestore continued to recognize revenue from barter transactions. Beginning in fiscal year 2000, after EITF No. 99-17 went into effect, Homestore and Wolff knowingly entered into fraudulent barter transactions. In the first component or "leg" of each transaction, Homestore paid cash at an inflated price to each company in exchange for advertising and other services. In the second leg, each company recycled the cash received from Homestore back to Homestore as payment for Homestore's advertising and/or services at inflated prices. The amount of the first leg of each transaction was almost identical to the amount of the second leg of the same transaction. Homestore then improperly recognized the

inflated value as revenue on its financial statements, while at the same time trying to deceive PWC to approve them.

3. Buying Revenue

39. Buying revenue is another barter transaction where Homestore used cash, stocks or warrants to purchase advertising and/or services at inflated prices from third parties. The third parties would then buy advertising from Homestore at inflated prices. The result was that both companies improperly recognized the inflated values as revenues on their financial statements.

40. The template for buying revenue occurred as early as fiscal year 1998, when Homestore entered into such a transaction with RE/MAX International, Inc. ("RE/MAX"). In this transaction, Homestore paid RE/MAX $5 million for a five-year exclusive listing. RE/MAX then paid Homestore $5 million for website development and hosting. The exclusive listing was recorded as an asset by Homestore while money received for the website development and hosting was improperly recognized as revenue.

41. As the scheme became more sophisticated and cash became increasingly tight, Homestore revised the scheme to use stock and warrants in lieu of cash. In 1999, Homestore entered into this type of transaction with Wells Fargo Bank. In the first leg, Homestore gave Wells Fargo 500,000 warrants at a strike price of $20 per share, and Wells Fargo supposedly provided marketing services to Homestore. In the second leg, Wells Fargo paid Homestore $20 million over two years and Homestore received an exclusive position on Wells Fargo's website.

42. By the first quarter of 2000, the frequency of Homestore's revenue buying transactions increased and the quality of the third party companies decreased as Homestore became only interested in generating revenues. In the first leg of each transaction, Homestore agreed to provide website advertising and pay cash for stock in each company. In the second leg, each company recycled the cash from Homestore back to Homestore as payment for Homestore's website

advertising at inflated prices and also provided stock in each company. Homestore then booked its recycled money as revenue.

4. Round Tripping with Hidden Leg

43. By the first quarter of 2001, Homestore, Wolff, and others knew that in order to keep generating revenues, they would need additional companies as partners. Certain of these fraudulent schemes, designed and implemented by Peter Tafeen and Eric Keller of AOL, involved multiple components, or "legs." The schemes involved round-trip transactions.

44. Beginning in the last quarter of fiscal year 2000 and continuing into fiscal year 2001, Homestore and AOL entered into round-trip transactions with GlobeXplorer, Inc. (Q4 2000 & Q1 2001); WizShop.com, Inc. (Q4 2000 & Q1 2001); PurchasePro.com, Inc. (Q1 2001); Classmates Online, Inc. (Q1 & Q2 2001); and InvestorPlus (Q2 2001). Each of these companies had products which were of minimal value, but they were willing to enter into these fraudulent transactions in return for a kickback. The primary purpose of the transactions, known to the participants, was to generate revenue for Homestore.

45. In the end of the first quarter of 2001, Homestore entered into a series of illegal transactions designed by Tafeen and Keller, with the knowledge and approval of AOL's David Colburn, whereby Homestore and AOL would conduct triangular sham transactions with third party vendors. Negotiations about the first of these transactions coincided with discussions between Homestore and AOL about a potential merger which would have consolidated the companies and dissolved any evidence of improper round-trip transactions.

46. The concept for this sham deal with AOL was the cumulation of the evolution of deals that had been going on since 1999 as herein alleged. At their core, the deals were structured by AOL and Homestore to buy revenue. In 1999, deals were made by Homestore using warrants to induce others to provide Homestore with revenue. In 2000, the deals evolved into distribution deals

whereby Homestore would invest in the distributor company. There were also deals whereby Homestore paid for equity and services. And finally, there were the triangular deals of 2001. During the first quarter of 2001, Homestore recognized approximately $15 million in revenue from these fraudulent round-trip transactions.

47. The triangular deals involved one leg where Homestore would pay third party vendors for some service or product that Homestore had no real use for, a hidden second leg wherein the *quid pro quo* for the first leg was that the third party vendor would buy Homestore advertising with AOL, and a third leg where AOL would "round-trip" the money which started with Homestore back to Homestore.

48. In the first leg, Homestore paid these companies approximately $50 million in the aggregate purportedly for services, technology, advertising and/or content. The first leg was a sham transaction because Homestore received nothing of value in return, but it was necessary to supply money to these companies so that they could fund the third leg. Shew knew that Homestore paid money to the vendors because he reviewed agreements and signed wire authorizations. Stuart Wolff also signed such wire authorizations, and when he asked about them, Shew explained they were related to the AOL revenue deals.

49. In the second leg, AOL paid cash to Homestore for advertising. AOL and Homestore knew the money from AOL to Homestore was the same money that the vendors paid to AOL because of conversations Shew had with Steve Rindner and Joe Ripp of AOL that AOL had an obligation to pay Homestore since AOL had received its money from the vendors.

50. The third hidden leg was the bridge between these two transactions and was the "round-trip" which was the *quid pro quo* for the deal. This is where the third party company used the money received from Homestore to buy advertising from AOL. AOL received payment from the vendors for the

advertising. As Shew explained, "those third party vendors were just a vehicle to hide it from Pricewaterhouse the money coming back from AOL. That's all they were used for." The third hidden leg occurs prior to the second leg.

51. The second and third legs work together, though each misrepresented Homestore's revenues. Shew recalled a June 28, 2001 conference call with AOL in which Homestore told AOL that AOL needed to pay Homestore since AOL had received Homestore's money from the vendors. During that call, Shew told AOL that its accounting department confirmed that four vendors had paid AOL, contrary to AOL's assertions of non-payment. Ripp said that he would check with his cash department to see whether Shew's statement was accurate. Because the vendors had paid AOL, AOL was supposed to pay Homestore. As explained above AOL recycled that money back to Homestore, which then improperly recognized that money as revenue. Under the various advertising representative agreements between AOL and Homestore, AOL retained as much as 68.2%, in the form of a sales commission, of what Homestore paid the vendors.

52. According to Shew, there was no formal agreement that documented this triangular flow of cash. The advertising representative agreement and the advertising referral agreement documented only the relationship between AOL and Homestore. At their core, each of these illegal transactions is structured to buy revenue. These agreements did not mention Homestore's payments to the vendors, the agreement by the third party vendors to buy advertising from AOL, or that the same money was sent from the vendors to AOL.

5. <u>Insider Profiteering (Wolff)</u>

53. Wolff and others personally profited from these round-trips. Within days after quarterly revenues were reported and after the market reacted by increasing the price of Homestore stock, a trading window opened to allow company insiders to sell their stock; it is not coincidence that Wolff, who participated in these round-trip transactions, regularly sold his stock immediately

after the quarterly window opened and reaped millions of dollars in insider trading profits. During the Class Period, Wolff sold 693,600 shares of Homestore stock for proceeds of $33,763,389.75.

6. Discovery of the Fraudulent Scheme

54. The fraudulent scheme to artificially inflate Homestore stock was finally exposed in December 2001 when Homestore was forced to announce that revenues for all four quarters of 2000 and the first three quarters of 2001 had to be restated because Homestore had improperly recognized revenues from these bogus transactions. As a result of this restatement, Homestore's stock price plummeted. While the insiders reaped millions of dollars in profits, the Plaintiff Class members suffered massive losses in the value of their stock.

B. SCIENTER AND THE CONDUCT OF CENDANT AND SMITH

55. Cendant Corporation provides travel and real estate services. Its businesses provide a wide range of consumer and business services. The Real Estate Services segment franchises the real estate brokerage businesses of the Century 21, Coldwell Banker, Coldwell Banker Commercial and ERA brands. The Hospitality segment operates the Days Inn, Ramada, Super 8 Motel, Howard Johnson, Wingate Inn, Knights Inn, Travelodge, Villager Lodge, Village Premier, Hearthside by Villager and AmeriHost Inn. The Vehicle Services segment operates and franchises Avis, the Company's car rental business. The Travel Distribution segment provides global distribution and computer reservation services to airlines, hotels, car rental companies and other travel suppliers. The Financial Services segment provides enhancement packages to financial institutions.

56. The business alliance between Cendant and Homestore began as early as 1998 when Homestore paid Cendant $13 to $15 million for an agreement not to compete. Wolff viewed a relationship between Cendant and Homestore as critical

to Homestore's success because portions of Cendant's business empire directly competed with Homestore.

57. According to a October 22, 1999, Homestore press release, the alliance agreements provided for: (i) exclusive endorsement by Cendant of Homestore.com's web page design, hosting and maintenance services to the brokers and sales associates of Cendant's Century 21, Coldwell Banker and ERA residential real estate franchise systems; (ii) active assistance by Cendant to Homestore.com in marketing such web-based products and services to the brokers and sales associates and (iii) granting the exclusive third-party license to use the approximately 400,000 electronic listings of the three Cendant brands to Homestore.com, along with Cendant's promotion of Homestore.com as a leading online distributor of those listings. Shortly thereafter, the relationship soured and litigation ensued. In October 1999, according to Homestore's October 22, 1999 press release, the companies settled their differences and reaffirmed their previous alliance agreements. "As part of the settlement, Cendant will receive 250,000 shares of Homestore common stock and will take various actions to reaffirm its alliance agreements with Homestore.com," the press release stated.

1. Homestore's Round Trip With Cendant

58. Homestore entered into and misrepresented a fraudulent circular transaction with Cendant in the first quarter of 2001 in which Homestore obtained revenue in exchange for Cendant getting an ownership interest in Homestore. In the first leg, Homestore gave Cendant 21.4 million shares for Homestore stock worth approximately $750 million. In return, Homestore received 100% of the stock in two Cendant subsidiaries, Move.com and Welcome Wagon.

59. In the second leg, Cendant funded its Real Estate Technology Trust ("RETT") with $95 million. RETT was the vehicle which Cendant used to funnel money to Homestore so that Homestore could meet its quarterly revenue targets.

60. The third leg involved a deal between RETT and Homestore where Homestore agreed to pay $80 million over two years in return for purported commercial products and services. *See* attached Exhibit B.

61. The three legs of the Cendant-Homestore transaction were simultaneous and contingent upon each other. In fact, the Homestore and RETT transactions were between related parties and as such, were not arms' length transactions, which should have been disclosed. Homestore's auditor, PWC, was concerned enough about the reciprocal nature of this deal to get its national office involved.

62. These transactions lacked any economic substance because Homestore knowingly greatly overpaid for Move.com and Welcome Wagon, and RETT agreed to buy products without even knowing the specific products it was buying.

63. As a result of these transactions, Cendant obtained 20% ownership in Homestore and placed one voting member, Defendant Smith, on the Homestore board of directors. Since Cendant owned such a large share of Homestore, Cendant wanted revenues to continue flowing to Homestore.

2. The Move.com Acquisition

i. Cendant Wants to Keep Move.com Off its Income Statement Because Move.Com Was Losing Money

64. In or about January 2000, Cendant and the National Association of Realtors launched Move.com, an Internet website to offer relocation and other real estate services to consumers. By early 2000, Cendant realized that Move.com was not going to be a profitable company and it did not want Move.com included on its profit or loss statement, though it wanted to maintain this type of Internet site since it was complementary to its real estate business. Cendant first tried to carve out Move.com by making it a "tracking stock." On February 9, 2000, Cendant filed a Proxy Statement, Schedule 14A, with the SEC regarding its intent to make

Move.com a tracking stock. The Proxy Statement explained to the shareholders that tracking stock:

> [S]ometimes referred to as "alphabet stock," "letter stock," or "targeted stock," is a common stock that represents an ownership interest in the corporation that issues it but it is designed to reflect, or track, the performance of a specified group of the corporation's assets or business. It is therefore said to track the performance of those assets or businesses. We propose creating a new series of tracking stock, to be designated as Move.com Stock, and reclassifying our existing common stock into a new series of common stock to be designated as CD stock.

65. On February 14, 2000, Cendant issued a press release announcing that it had filed a Registration Statement with the SEC relating to the initial public offering of Move.com tracking stock to spin the unit off. Cendant planned to sell $150 million of Move.com stock.

66. On March 21, 2000, Cendant announced in a press release that its shareholders had voted to approve the Move.com tracking stock. Cendant, however, never issued tracking stock in Move.com; instead, in a June 6, 2000 press release, it announced it had postponed the public offering: "Citing current market conditions, Cendant Corporation (NYSE: CD) announced today that it has postponed the public offering of Move.com Group tracking stock." Cendant was, however, in April of 2000 able to sell about 1.5 million shares of Move.com in a public placement to Liberty Digital in exchange for Cendant and Liberty Digital's agreements "to use good faith efforts to enter into mutually acceptable agreements relating to the development of real estate-related programming for Liberty Digital's interactive television initiatives based on Move.com Group's Web content. (April 4, 2000 Cendant press release, "Liberty Digital, Chatham, Street Holdings and NRT Take Equity Stake in Cendant's Move.com; Cendant Stock Reclassified."). The same press release reported that Chatham Street Holdings, LLC exercised a contractual right to purchase about 1.5 million shares of Move.com in a private placement and NRT Incorporated also agreed to purchase about 318,000 shares in a private placement.

67. Since it was unable to issue Move.com as a tracking stock, while still wishing to keep Move.com's losses from its revenue statements, Cendant Corporation reported revenue figures, <u>excluding</u> Move.com losses. For example, Cendant's report of first quarter 2000 results stated: "First quarter results and other recent activities include: [¶] Adjusted earning per share, excluding Move.com Group, were up 24% to $0.26 versus $0.21." As to Move.com, Cendant reported:

> Move.com group recorded revenues of $11 million as compared to $3 million in the prior year period. Adjusted EBITDA decreased $26 million to a loss of $26 million in 2000. These results reflect increased investment in marketing and development of the new real estate services Internet portal, which was launched in January. The Company expects Move.com Group will continue to report losses in the foreseeable future resulting from continuing investment in the growth of the business.

68. In its Statement of Financial Results of Operations, Cendant separated the Cendant revenues and expenses from the Move.com revenues and expenses.

69. In reporting results for the third quarter of 2000, Cendant, once again, separated the Cendant revenues and expenses from the Move.com revenues and expenses. Regarding Move.com, Cendant reported:

> Move.com revenues tripled because of higher sponsorship revenues made possible by the first quarter 2000 launch of our Internet real estate services portal, Move.com. The company expects Move.com will continue to report losses for the foreseeable future resulting from continuing investment in the growth of the business.

Cendant continued to report financial information, excluding Move.com.

70. Similarly, for periods after March 31, 2000, the date that Move.com common stock was originally issued, Cendant began calculating and publicly reporting earnings per share using the two-class method to prevent the poorly performing Move.com from negatively affecting its financial statements. As Cendant explained in its 10-Q report for the period ended September 30, 2000: "The two-class method is an earnings allocation formula that determines EPS for each class of common stock according to the related earnings participation rights."

The two classes were Cendant Common Stock and Move.com Common Stock. This practice continued throughout the Class Period.

71. In a November 13, 2000 press release, Cendant stated that, excluding Move.com, its fourth quarter adjusted earnings per share met Wall Street estimates:

> The Company will reiterate that its expectations for fourth quarter 2000 adjusted earnings per share are in line with published Wall Street estimates. Adjusting for the reclassification of the Individual Membership segment as a discontinued operation, the Company expects fourth quarter 2000 adjusted earnings per share from continuing operations and <u>excluding Move.com</u> to be $0.18 and full year 2000 adjusted earnings per share from continuing operations and excluding Move.com to be $0.90.
>
> The Company also will announce that preliminary projections, including the benefit of the pending acquisitions of Avis Group and Fairfield Communities, for adjusted earnings per share from continuing operations and <u>excluding Move.com</u> are $0.91 in 2001, $1.06 in 2002 and $1.21 in 2003. The growth rate in 2001 will be negatively affected by the incremental interest from the common stock class action litigation settlement. (Emphasis added).

72. On December 20, 2000, Cendant once again "reiterated that it projects adjusted earnings per share from continuing operations, including the benefit of the pending acquisitions of Avis Group and Fairfield Communities and excluding Move.com's operating results and the impact of the sale to Homestore.com, to be $0.91 in 2001." The press release also stated: "The Company announced the following financial projections from continuing operations, excluding the results of Move.com, for first quarter 2001: . . . ."

ii. <u>Homestore Agrees to Acquire Move.com in October 2000</u>

73. On October 27, 2000, Homestore and Cendant, including statements by Richard Smith, announced in a joint press release that Homestore had signed an agreement on October 26, 2000 to acquire Move.com from Cendant Corporation. The press release announcing the deal stated:

The transaction combines the Internet's two leading Web sites in the home and real estate category under the Homestore.com brand. . . . The transaction also ensures that Homestore.com's Web site REALTOR.com will have exclusive 40-year access to the aggregated listings of Cendant Corporation's Century 21, Coldwell Banker and ERA national real estate franchises and includes an agreement by **Cendant** to purchase Homestore.com's technology and web-based marketing products and vertical ASP solutions.

In addition, Cendant will invest in Homestore.com's development of the Realtors Electronic Transaction Platform (eRealtor.com, the official real estate transaction platform of the National Association of Realtors) helping to unite industry participation behind Homestore.com's technology solution for online real estate transactions. . . .

Under terms of a definitive agreement signed yesterday, Homestore.com, Inc. will acquire Move.com in an all-stock transaction totaling approximately 26.3 million shares of the company's common stock. Based on yesterday's closing price of $28.953 per share, the transaction is valued at approximately $761 million.

"**We are committed to building the most vibrant and comprehensive online home and real estate marketplace possible at Homestore.com for the benefit of all of our consumers and professional customers," said Stuart Wolff, Homestore.com's chairman and chief executive officer**. "With this transaction, we're increasing choices for consumers nationwide while continuing to put the real estate professional center stage. This is a giant step forward," **Wolff said**.

Cendant's chairman, president and chief executive officer, Henry R. Silverman stated: "Homestore.com has done an outstanding job establishing itself as the leading Internet real estate destination, and we are very pleased to align our expanding New Economy efforts with them. The benefit of this transaction is twofold: first, it provides the expertise of an Internet industry leader to enhance our real estate brands' Web sites and technology to benefit franchisees and consumers. Furthermore, it benefits our shareholders based on their investment in Move.com and demonstrates the successful execution of Cendant Internet Group's strategy."

Chairman and CEO of Cendant's Real Estate Division, Richard A. Smith said: "This business combination is expected to enhance Cendant's off-line real estate businesses and franchise systems. Licensees and consumers will clearly benefit from this transaction through compelling new e-commerce services, as well as joint marketing and promotional opportunities." "We are most excited about this latest acquisition because it forges together the expertise, resources and talents of the largest real estate franchises and creates, on one stage, a platform for real estate professionals to provide consumers efficient services in today's complex marketplace," said NAR President Dennis R. Cronk.

* * *

Homestore.com said it expects the acquisition, which brings with it new revenue streams and cost synergies, to be accretive to the company's fiscal 2001 earnings. Longer term, the company anticipates a variety of synergistic opportunities resulting from the merged assets, as well as increasing financial benefits from the economies of scale the transaction will make possible.

Homestore.com's acquisition of Move.com is subject to a number of customary conditions including, among other things, the approval of Homestore.com, Inc.'s shareholders, and regulatory review under the Hart Scott Rodino Antitrust Improvements Act. The transaction is currently under review by the antitrust division of the Department of Justice. Upon closing, Cendant Corporation will be entitled to name one director to Homestore.com's board, which currently has six members. Cendant also will be restricted in its ability to sell its Homestore.com shares and has agreed to vote its shares on all corporate matters in proportion to the voting decisions of all other shareholders. In addition, Cendant has agreed to a ten-year standstill agreement that, under most conditions, prohibits the company from acquiring additional Homestore.com common shares. Homestore.com and Cendant Corporation said they expect to complete the transaction within the next six months.

The transaction includes the following key elements:

Homestore.com will integrate Move.com and its related assets including Rent Net, a leading residential rental listing and apartment finder service on the Internet, into the Homestore.com network, combining two of the most popular and traffic-generating real estate destinations on the Web today. The transaction does not include National Home Connections (NHC) or Metro Rent, which will be retained by Cendant.

Additionally, for 40 years, Homestore.com will acquire the exclusive rights to the aggregated online residential real estate listings of Cendant's Century 21, Coldwell Banker and ERA national real estate brokerage franchises, which also will continue to be featured on those brands' respective Internet sites. Cendant and Homestore.com, Inc. will also enter into an agreement to develop Internet-based technology and tools that will provide even greater choices for real estate brokers and agents. Cendant's real estate franchisees are currently involved in approximately 25 percent of U.S. residential real estate transactions and annually assist more than 1.5 million buyers and sellers of single family homes.

Cendant will become an equity investor in Homestore.com's technology project to develop an online real estate transaction platform (eRealtor.com, the official real estate transaction platform of NAR), joining current participants including the National Association of Realtors, Fannie Mae, GMAC Real Estate, GMAC Mortgage and VeriSign. Prudential Real Estate Network and RE/MAX also endorse the transaction platform. With the participation of Cendant's three national franchise organizations, Homestore.com will unify six of the largest U.S. national residential real estate franchises behind

> Homestore.com's industry standard for online real estate transactions. Cendant Mobility, Cendant's relocation company and NRT Incorporated, Cendant's largest real estate franchisee, also have agreed to use the transaction platform exclusively for a period of three years. These two organizations accounted for more than 400,000 transactions last year. Homestore.com will also have the ability to host the Internet sites of Cendant's three real estate brands.
>
> Cendant's three national real estate franchises have committed to develop a series of cross-marketing and advertising programs with Homestore.com's family of Web sites (including REALTOR.com), including an agreement to include the REALTOR.com URL in a minimum of 50 percent of the three franchises' offline advertising campaigns.
>
> Finally, Homestore.com will acquire all rights to Welcome Wagon, the widely recognized direct marketing program that introduces participating neighborhood retailers and their services to new homeowners. Homestore.com plans to leverage the brand equity of the 72-year-old company to expand and enrich Homestore.com's local retail e-commerce business strategies. Welcome Wagon represents a network of more than 35,000 merchants and reaches 1.8 million new homeowners annually. (Emphasis added).

74. This press release states that <u>Cendant</u> will "purchase Homestore.com's technology and web-based marketing products and vertical ASP solutions." The release does not disclose that Cendant will purchase the technology through RETT so that the transaction could be hidden. The deal was actually structured as a three-way deal wherein the purportedly independent RETT was to purchase the technology. The transaction was structured this way so that the related party transaction between Cendant and Homestore would not be disclosed on Homestore and Cendant's financial statements. The failure to disclose was materially misleading and caused the stock to fraudulently increase and in violation of accounting standards and SEC rules.

75. On October 27, 2000, Homestore, with Richard Smith's participation, hosted an Investor Conference Call and Webcast to discuss the acquisition. Homestore, Cendant and Smith all failed to mention the role of RETT in the Move.com deal in either the press release or Investor Conference Call. At the time, all three knew that the Move.com deal was contingent on Cendant's

contribution to RETT. Homestore's stock **jumped 31%** to $37.94 that day from the previous day's close of $28.95.

76. On November 3, 2000, Cendant filed with the SEC an 8-K disclosing that Cendant and Homestore had executed the Agreement and Plan of Reorganization for Homestore's acquisition of Move.com. The 8-K attached the companies' joint press release. The press release fails to mention that Cendant will contribute $95 million to RETT or an "independent technology trust," or that the Move.com deal was contingent upon Cendant's $95 million contribution to RETT.

77. Wolff recognized very early on that in order for Homestore to succeed it would have to obtain an exclusive listing arrangement with a massive real estate conglomerate such as Cendant. Cendant carried approximately 30% of the total real estate listings in the United States.

iii. <u>Cendant's Omissions and Misrepresentations Regarding the RETT Funding</u>

78. As part of the Move.com deal, Cendant agreed to fund its RETT with $95 million. Cendant funded RETT to channel false revenues to Homestore to artificially inflate Homestore's stock price. RETT was funded without any specific deals for products and services between Homestore and Cendant. Further, Shew testified that Cendant, because of its approximately 20% stock ownership in Homestore, had a vested interest to keep Homestore's stock price high. This vested interest in Homestore caused Cendant to fund an inherently fraudulent and deceptive vehicle, RETT, which allowed Homestore to falsely inflate its revenues. In effect, RETT was a sham company used by Cendant to enter into fraudulent transactions with Homestore, and to hide the related party transaction.

79. In a filing with the SEC, Cendant stated that the purpose of establishing RETT was to acquire technology on behalf of Cendant. However, Shew testified that RETT was funded by Cendant to produce revenue for

Homestore. Cendant never publicly revealed that RETT was funded without any specific deals for products and services between Homestore and Cendant.

80. Contrary to Cendant's public statements regarding the Move.com deal, Cendant unloaded Move.com on Homestore with both sides knowing that Move.com was a drag on Cendant's financial position. According to Shew, "it became obvious...that they [Cendant] weren't going public with Move.com. So they needed to either -- effectively [sic], one of two things, bite the bullet and keep it themselves, which would have meant consolidating those big losses back into their earnings per share, or sell it to us at Homestore." Shew further testified that the acquisition was not a good deal for Homestore. Cendant needed to rid itself of Move.com, and Homestore needed a partner to help "make the bogie." Both knew the transaction was over-valued. Cendant knew that Homestore needed its help to meet quarterly targets, and Homestore knew that Cendant by virtue of its newly vested interest could not allow Homestore to fall short of its revenue targets. According to Plaintiff's confidential sources, this acquisition deal <u>would not</u> have been carried out without the $80 million in guaranteed revenue for Homestore from RETT. Homestore would agree to the Move.com acquisition <u>only if</u> it could receive money from RETT. Moreover, Shew, Wolff, Tafeen, and Giesecke were fully aware of the nature of the merger and the related component transactions. In effect, Cendant funded RETT for Homestore in a *quid pro quo* for Homestore agreeing to acquire Move.com in a related party transaction. Cendant never disclosed to the investing public its true reason for so generously funding RETT for Homestore in connection with the Move.com deal and did not disclose, as required by the applicable rules, the related party transactions between Cendant, Homestore and RETT on its financial statements.

81. In February 2001, the acquisition of Move.com was approved and Cendant fulfilled its obligation to fund RETT with $95 million. In order to avoid a negative reaction on Wall Street, in its 8-K filing of April 18, 2001, Cendant

falsely described the $95 million contribution as an unusual charge for purposes of deriving Adjusted EBITDA and Adjusted EPS.

> A charge totaling $95 million ($62 million or $0.07 per share after tax) to fund a contribution to an independent technology trust responsible for providing technology initiatives for the benefit of current and future franchisees at Century 21, Coldwell Banker and ERA. (Emphasis added).

This statement is misleading because it does not mention that the contribution the "independent technology trust" is actually RETT, a related party to Cendant. Nor does the statement mention that the contribution was contingent on the completion of the Move.com acquisition. Moreover, this statement omits that $80 million of the $95 million was initially earmarked for Homestore rather than the stated purpose to benefit franchisees.

82. In its February 26, 2001 Schedule 13D filing with the SEC, Cendant attached the Agreement and Plan of Reorganization (the "Reorganization Agreement") for the Move.com acquisition. This disclosure is materially misleading and incomplete because the Reorganization Agreement does not mention Cendant's contribution to RETT or an independent technology trust, or that Homestore insisted on such contribution as a closing condition.

83. Cendant filed an 8-K statement on January 31, 2002 to provide information regarding its investments in affiliated entities. With respect to RETT, Cendant stated:

> Real Estate Technology Trust ("RETT") was established in 1996 to provide technology services and products to Cendant's real estate franchisees. Total contributions to this trust were $120 million, **including a $95 million contribution made in the first quarter of 2001**, **all of which has been expensed through the Company's income statement**. At December 31, 2001, RETT had no outstanding debt and does not have any obligation to make additional contributions. (Emphasis added).

This statement again omits that $80 million of the $95 million contribution was dedicated to Homestore, or that the contribution was part of a round-trip transaction with Homestore. This is also the first time Cendant publicly disclosed that the $95 million went to RETT. Cendant's previous statements cryptically referred to a $95 million contribution to an “independent technology trust.” Cendant’s references to an “independent technology trust” are misleading because of the close relationship between RETT, Cendant, and Homestore, as alleged below.

84. In its amended 2001 10-K filing (10-K/A) dated August 14, 2002, Cendant described its 2001 unusual charges as follows:

> The 2001 charges consisted primarily of (i) $95 million related to the funding of an irrevocable contribution to the Real Estate Technology Trust, an independent technology trust responsible for providing technology initiatives for the benefit of certain of our current and future real estate franchisees. ...

85. Although Cendant established RETT as a separate entity, one of Plaintiff’s confidential sources states that any deals with RETT were initiated and carried out by contacting Cendant directly. Homestore’s primary contacts at Cendant were Defendant Smith, who was a voting member of Homestore’s board of directors, David Weaving and Eric Bock.

86. Despite Cendant’s public statements that the RETT was “independent,” RETT and Cendant were clearly related parties. Tafeen testified in Wolff’s criminal trial that he understood Cendant and RETT to be the same entity. Shew testified that PWC auditor Richard Withey told him that RETT was in fact Cendant. Shew characterized Homestore’s relationship with Cendant as “**incestuous**” based on (1) Smith being a voting member of Homestore’s Board of Directors; (2) Cendant’s 20% stake in Homestore; and (3) Homestore paying Cendant in Homestore stock for Move.com.

87. Because RETT and Cendant were related parties, RETT was a mere pretense to falsely increase Homestore’s revenues and stock price. Therefore, Cendant funded RETT to falsely inflate Homestore’s revenues and stock price.

88. During the Class Period, all of Cendant’s public statements regarding the $95 million contribution were materially incomplete and misleading because they referred to RETT only as an “independent technology trust.” This reference

does not inform investors that RETT is a Cendant entity, or that Cendant and RETT are related parties.

89. Indeed, Homestore finally disclosed the true facts in its amended 10-Q statement (10-Q/A) for the quarter ended March 31, 2001, filed on March 29, 2002, that the transactions with RETT were with a related party and were contingent upon the Move.com deal:

> In connection with and contingent upon the closing of the acquisition of the Move.com Group during 2001, the Company entered into a series of commercial agreements for the sale of various technology and subscription-based services to Real Estate Technology Trust ("RETT"), an independent technology trust established in 1996 to provide technology services to Cendant's real estate franchisees that is considered **a related party of the Company.** Under the commercial agreements, RETT committed to purchase $75.0 million [after subtracting the $5 million Top Presenter deal] in products and services to be delivered to agents, brokers and other Cendant real estate franchisees over the next three years.
> [brackets and emphasis added]

These related-party relationships were never properly disclosed by Cendant, which had a duty to disclose them under Statement of Financial Accounting Standards No. 57 and Rule 4-08(K) of Regulation S-X during the Class Period. This was a material omission by Cendant which was intended to, and did, fraudulently inflate Homestore stock.

90. **Cendant's use of RETT was a deceptive act to ensure that Homestore had access to an artificial revenue stream supplied by Cendant**. The amorphous, unspecified structure alone was illegitimate because it boosted Homestore's revenues and corresponding stock price without any real business purpose. Cendant's vague and incomplete public statements regarding the RETT, and its failure to disclose the related party nature of the transaction and the amount of the transaction misled investors regarding Homestore's financial condition.

iv. Top Producer Deal (Q4 2000)

91. On June 12, 2000, Homestore issued a press release announcing its acquisition of Top Producer Systems, Inc. ("Top Producer") for approximately $24.2 million in Homestore common stock and cash. As a part of the deal, the

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founding shareholders of Top Producer were entitled to receive up to $16.2 million over the following four years if certain performance targets were met.

92. During the same quarter that Homestore and Cendant were touting the impending acquisition of Move.com by Homestore, the two companies entered into an improper transaction. In the fourth quarter of Fiscal Year 2000, Cendant purchased $5 million of a Top Producer product called Top Presenter. According to Plaintiff's confidential sources, this purchase was made in the last week of the quarter and was meant to help Homestore make its numbers in order to boost Homestore's common stock price for the benefit of Cendant, which stood to gain a 20% interest in Homestore upon the completion of Homestore's Move.com acquisition. As a direct result of this $5 million purchase, Cendant's obligation to provide $80 million in revenue under the Move.com acquisition agreement to Homestore was reduced to $75 million.

93. Homestore immediately recorded this deal as revenue, but according to Plaintiff's confidential sources this act was considered highly questionable because under SOP 97-2, the software required customization after the quarter was completed. SOP 97-2 would not allow recording this deal as revenue until the customization was complete. The customization required was valued at between $100,000-$200,000 and the product could not be used or shipped to Cendant until completion of the customization. Nevertheless, Homestore immediately recorded the revenue from the deal.

94. Shew testified that Cendant purchased Top Presenter, which acquisition was orchestrated by Tafeen, solely to help Homestore meet its quarterly revenue target. However, Cendant failed to publicly disclose that the purchase reduced its RETT funding obligation in connection with the Move.com deal.

v. <u>Homestore's Acquisition of Move.com Is Completed</u>

95. On January 11, 2001, Homestore issued a press release announcing that "a majority of its shareholders approved the issuance of additional shares of

common stock in conjunction with the company's proposed acquisition of Cendant Corporation's real estate portal, Move.com. The company expects to issue approximately 26.3 million shares of stock upon closing. The transaction is expected to close as soon as practicable following regulatory review under the Hart Scott Rodino Antitrust Improvements Act."

96. On February 15, 2001, Homestore announced that the Department of Justice had completed its investigation and approved Homestore's acquisition of Move.com. That day, Homestore's stock price rose from $29.94 to $34.97 – a 17% increase.

97. On February 20, 2001, Homestore announced that it had completed its acquisition of Move.com.

98. As a result of Homestore's acquisition of Move.com, Cendant obtained a 20% ownership stake in Homestore and two positions on Homestore's Board of Directors. Richard A. Smith, Chairman and CEO of Cendant's Real Estate Group, became a voting member of Homestore's Board of Directors and Sam Katz, CEO of Cendant's Internet Group, became a non-voting member of Homestore's Board of Directors. This relationship became crucial to Homestore's ability to meet or exceed its quarterly revenue projections. In fact, Plaintiff's confidential sources recall that Tafeen privately described Cendant as a sure source of revenue in the event that Homestore needed last minute revenues at the end of a quarter to "make the bogie."

99. Homestore's acquisition of Move.com fulfilled Wolff's vision of market dominance and solidified Homestore's position in the public's mind as the leading source of online real estate listings. Through the acquisition, Homestore's Realtor.com obtained exclusive online use of aggregated listings of the nation's largest real estate brands. *See* Realtor.org: "Dramatic Moves At Homestore.com Will Keep REALTORS at the Forefront of the New Economy," December 12,

2000; *The Richmond Times Dispatch*: "Selling By Executive At Low Prices Ominous Sign," December 25, 2000.

100. According to Plaintiff's confidential sources, a divergence of opinion between Homestore's auditor, PWC, and Cendant's auditor, Deloitte & Touche, developed in the first quarter of 2001 regarding how to account for deals between Homestore and RETT. PWC determined that these transactions should be recorded as related party transactions, but Deloitte & Touche disagreed. Initially, PWC gave into Cendant's views on the subject and the transactions were not disclosed by Cendant or Homestore. Cendant's financial statements also failed to disclose that Cendant and RETT were related parties. Under applicable accounting rules, including Statement of Financial Accounting Standards No. 57, the transactions should have been disclosed.

3. <u>The Preferred Alliance Agreements</u>

101. During the first quarter of fiscal year 2001, Homestore acquired iPix. Giesecke was in charge of integrating iPix operations with Homestore. According to Plaintiff's confidential sources, after Homestore's acquisition of iPix was complete, Homestore once again began a desperate search for additional revenues to meet Wall Street's earnings expectations.

102. To meet those expectations, Homestore turned to Cendant. Tafeen knew that Cendant had funded RETT with $95 million and that only $80 million of that funding was committed to Homestore. Thus, Tafeen turned to Smith for the remaining $15 million. According to Plaintiff's confidential sources, Cendant agreed to purchase through RETT $15 million worth of iPix virtual tours from Homestore, but only if Homestore would agree to purchase $15 million in products from Cendant at a later date. The sale took place over two quarters. The first sale took place in June 2001 and was for $9 million. The second sale occurred on September 28, 2001 and was for $6 million.

103. Virtual tours are online videos that permit the user to view the interior of a property. For example, the user can view the kitchen, master bedroom, and kitchen from different angles. Virtual tours are seen as a powerful marketing tool.

104. Tafeen discussed this proposal with Shew and according to Plaintiff's confidential sources, Shew informed Tafeen that Tafeen could not sign the "give-back" contract with Cendant or PWC would not allow Homestore to recognize the $15 million as revenue. Shew advised Tafeen that he needed separation between the two deals, and that the contract could only be signed on the "give back" after the first of the year, 2002. Shew instructed Tafeen not to sign any agreement to "give-back" the $15 million because PWC would not allow Homestore to recognize the revenue if the transactions appeared to be simultaneous.

105. Several "red-flags" were obvious in this transaction. First, according to Plaintiff's confidential sources, Cendant understood that these virtual tours were full-service. However, Homestore booked the tours as self-service in order to be able to record the revenue immediately. Cendant never intended to use self-service tours, but characterized them as such so Homestore could book the revenue. Second, according to Plaintiff's confidential source, this transaction raised concerns for DeSimone and Kalina because Cendant's purchase of $15 million in virtual tours was grossly excessive, an action by Cendant designed to misrepresent the legitimacy of Homestore's revenues. More specifically, $15 million in full-service virtual tours is more than any purchaser could use in 20 years and, if PWC looked at the sale, it would object to the valuation of the virtual tours. If the tours were full-service, they would be booked as revenue as they were used since there would be further work to implement them. If they were deemed self-service, the revenue could be booked immediately. Accordingly, Homestore changed the virtual tours from full-service to self-service, so that the revenue could be booked

immediately. This facial change in the character of the tours, and the fact that the parties to the transaction were related, imposed an obligation on PWC to sufficiently challenge the economic substance of the transaction, and not just accept it. In fact, Cendant had no intention of doing any self-service virtual tours according to Plaintiff's confidential sources. Thus, this transaction was questionable and the iPix revenue recognition under FASB 57 and AU Section 150 was inappropriate.

106. Nevertheless, Tafeen executed this illegal transaction agreeing to "give back" $15 million to Cendant in the first quarter of 2002. According to Shew and Giesecke, Tafeen entered into a series of four unauthorized, significant contracts on behalf of Homestore with Cendant – the Preferred Alliance Agreements. *See* attached Exhibit C. Tafeen admitted that he entered into these agreements without any authorization or approval.

107. Defendant Smith, because of his positions as a director of Homestore and executive of Cendant, had the authority to facilitate, as well as prevent, the fraudulent events that occurred. Because of his personal knowledge, Smith could have corrected the release, to the press, securities analysts and SEC, of incomplete and misleading statements by Homestore, Cendant, and himself. Smith deliberately disregarded the impact that the misleading statements and omissions would have on the Homestore stock and the integrity of the market. For these reasons, Smith has acted with scienter.

108. According to Plaintiff's confidential sources, Smith was a close friend of Wolff and was a primary contact at Cendant in the structuring of the false and/or deceptive barter deals between Homestore and Cendant.

109. Smith was personally involved in creating the improper deals on behalf of Cendant with Homestore. According to Plaintiff's confidential sources, in the Second Quarter of 2001, Homestore knew that it would come up short on its revenues. Smith agreed to do a deal with Homestore so that Homestore could

recognize revenue in the second quarter of 2001, on the condition that Homestore repay the favor in the first quarter of 2002. The deal was structured by Tafeen, who was told not to make any contracts in writing and to keep the deal oral.

110. Tafeen was quoted as saying that Cendant would help Homestore make its third quarter 2001 numbers because "Cendant has $10-$20 million and they're on our team, but we'll have to make it up to them."

111. According to Plaintiff's confidential sources, Homestore (Peter Tafeen) and Cendant entered into the first Preferred Alliance Agreement on July 15, 2001. This agreement obligated Homestore to pay Cendant $6 million to act as the exclusive vendor of certain services recommended by Cendant-related franchisers to franchisees.

112. According to Plaintiff's confidential sources, Homestore (Peter Tafeen) and Cendant entered into the second Preferred Alliance Agreement on October 5, 2001. This agreement obligated Homestore to pay Cendant $3 million to act as the exclusive vendor of the mobile products and related services recommended by Cendant-related franchisers to the franchisees.

113. According to Plaintiff's confidential sources, Homestore (Peter Tafeen) and Cendant entered into the third Preferred Alliance Agreement on October 19, 2001. This agreement obligated Homestore to pay Cendant $4 million to act as the exclusive vendor of community and school products recommended by Cendant-related franchisers to the franchisees.

114. According to Plaintiff's confidential sources, Homestore (Peter Tafeen) and Cendant entered into the fourth Preferred Alliance Agreement on October 19, 2001. This agreement obligated Homestore to pay Cendant $1.15 million to act as the exclusive vendor of community and school products recommended by Cendant Mobility to Cendant Mobility customers.

115. On October 3, 2001, Homestore announced that it would miss its revenue projections. With this announcement the Audit Committee began to ask

questions of the CFO and Finance Department. As late as November 5, 2001, Shew and David Weaving of Cendant conducted a telephone call to discuss potential revenue generating deals with Cendant. Shew was surprised when Weaving instead requested payment due under prior agreements signed by Tafeen. Shew asked that Weaving fax him a copy of the contracts and Weaving faxed the Preferred Alliance Agreements to him. Although the effective date of the agreements was 2002, the facsimile transmission demonstrates that the Preferred Alliance Agreements were simultaneous regardless of the delay in contract performance dates.

116. After Homestore had released its earnings on November 1, 2001, but before it filed its 10-Q on November 14, 2001, Shew discovered that Tafeen had entered into the Preferred Alliance Agreements with Cendant without authorization.

117. Shew realized that Tafeen, by entering into these agreements with Cendant, had done exactly what Shew had told him not to do. Shew was worried about PWC learning about the agreements because PWC would have told Homestore that it could not recognize revenue on the third quarter transactions with RETT. The revenues from Homestore's transactions with RETT were related to Homestore's Preferred Alliance Agreements with Cendant.

118. After learning about the Preferred Alliance Agreements, Shew testified that he immediately told Giesecke about the agreements and told him that the dates of the agreements were a problem because they were negotiated right around the same time as the September results. This timing would make it extremely difficult, if not impossible, for Homestore to be able to recognize the revenue for its third quarter deals with Cendant because the give backs were too close in time to the Cendant deals, making them contingent transactions.

119. Shew then notified Wolff about the Preferred Alliance Agreements. According to Giesecke, Wolff decided he wanted to rescind the Preferred Alliance

Agreements, if there was a legal way to do so, and "that the accounting that had been used in the quarter would stand."

120. According to Giesecke, after Wolff was told about the Preferred Alliance Agreements, Wolff interacted with Smith regarding having the agreements rescinded. Wolff and Smith discussed rescinding the agreement, while also allowing the accounting for the third quarter to stand. Thus, Wolff wanted to be able to report the revenues from the Preferred Alliance Agreements with Cendant on the 10-Q for the third quarter of 2001, even after the agreements were rescinded.

121. On November 13, 2001, Shew, Geisecke and Wolff called Smith and told him that Tafeen did not have authority to enter into the contracts with Cendant and that Homestore will not honor those agreements. They told Smith that Homestore had already issued its press release for the third quarter of 2001, and that the Preferred Alliance Agreements negotiated by Tafeen would mean a public restatement. Smith told Shew, Giesecke, and Wolff that he understood the issue and said he and Cendant would work on it.

122. Shew testified that Smith did not appear surprised to hear about the existence of the Preferred Alliance Agreements. Yet, Shew believes that as of November 13, 2001, the Homestore board did not know about the existence of the Preferred Alliance Agreements, even though Smith was a member of the Homestore board. According to Shew, Smith rescinded the contracts because Homestore had so requested. As a Homestore Board Member and a part of Cendant's management, Smith knew both sides of the Cendant deals and had a conflict of interest. Smith had concealed the existence of the agreements from the Homestore board because he did not want his role in their negotiation to be revealed. But Smith did not conceal the existence of the agreement from others at Cendant, including Dave Weaving.

123. After the November 13 phone call, Smith, as Chairman and CEO of Cendant's Real Estate Group and a Homestore board member, agreed to tear up the contracts and the transactions were nullified. According to Plaintiff's confidential sources, Wolff signed the letter of cancellation, which was addressed to Smith of Cendant. Homestore paid $100,000 to Cendant for costs and expenses related to the negotiation of the four agreements.

124. Giesecke testified that Smith's rescission of the Preferred Alliance Agreements allowed Homestore to recognize the revenue from the third quarter deal with Cendant. Smith tore up these agreements because Homestore needed him to do so they could make their revenue target. Cendant, because of its substantial ownership stake in Homestore, needed Homestore to meet its revenue numbers. Smith's dual role with Homestore and Cendant allowed him to facilitate the rescission of these Preferred Alliance Agreements. There was no legitimate business reason for Cendant to void these contracts other than to help Homestore conceal the true nature of its financial condition.

125. Gordon Davidson, Chairman of Fenwick and West, Homestore's counsel during November 2001, testified that the Preferred Alliance Agreements needed to be rescinded prior to the filing of the 10-Q "to avoid a question about recognition of revenue." In fact, Davidson gave Wolff advice on rescinding the agreements. Wolff told Davidson that he asked Cendant to rescind the contracts because they cast doubt on the revenue recognition of Homestore's revenue from Cendant. Thus, the existence of the Preferred Alliance Agreements was a reportable condition under Item 303 of Regulation S-K. However, Homestore avoided reporting their existence by rescinding the agreements, yet reported the third quarter revenues from the Cendant deal.

126. After Smith agreed to rescind the agreements, the 10-Q filed on November 14, 2001 was not immediately amended to disclose the existence of the Preferred Alliance Agreements and their implications for Homestore's revenues.

Cendant knew that these illegitimate agreements, and the voiding of them right before Homestore's third quarter 10-Q was released on November 14, 2001, presented a material risk that Cendant, Smith and Homestore had created a reportable condition that was not disclosed to the public or the SEC at the time the 10-Q was released.

127. According to Plaintiff's confidential sources, Homestore <u>restated</u> to zero non-advertising revenues <u>directly related</u> to the Preferred Alliance Agreements of $6 million in the second quarter of 2001, and $8.64 million in the third quarter of 2001. Thus, Homestore restated $14.64 million in revenues related to the Preferred Alliance Agreements for the nine months ended September 30, 2001.

128. By the end of the third quarter of 2001, Plaintiff's confidential sources reported that there were concerns by Homestore's executives on how they could put a "spin" on the company's declining revenues. Smith attended the meeting with Rosenblatt, Whelan, Ozonian, Sommer and Denhart. They and others decided to blame the company's woes on the September 11 tragedy and a declining Internet advertising market and a false statement was issued thereafter by Homestore.

129. Smith participated actively during the course of and in furtherance of the scheme to defraud to recognize false revenues for Homestore, and to conceal such information from the public. Smith's acts were intended to promote the objectives of the scheme to defraud. Despite his position on Homestore's Board of Directors, Smith knowingly and intentionally participated in Homestore's scheme to defraud and failed to reveal the fraud. Because Smith's conduct, statements, and failure to speak misrepresented and omitted material facts in furtherance of a scheme to defraud, he is liable as a primary violator under § 10(b).

130. Cendant wanted Homestore to be able to recognize the revenue it had received from Cendant's purchase of Homestore's products. Without Smith's actions, the Preferred Alliance Agreements would not have been rescinded, and Homestore's revenues could not have been deceptively inflated. The agreements

were rescinded solely to artificially inflate Homestore's revenues in furtherance of a scheme to defraud the investing public.

131. As a result of Cendant's and Smith's knowing deceptive acts, false statements and omissions which should have been disclosed, they committed primary violations of § 10(b).

C. SCIENTER AND THE CONDUCT OF WOLFF

132. Defendant Wolff, because of his position as an officer, director and employee of Homestore had the authority to facilitate, as well as prevent, the fraudulent events that occurred. Wolff had control over the misleading content of the quarterly and annual reports and had inside access to non-public, contradictory information, including Homestore's finances, products, markets, and present and future business opportunities. With full access to, and knowledge of, internal documents coupled with interactions with Homestore's management team, meetings and committees thereof, and employees, Wolff helped to create fraudulent filings and the false favorable reports surrounding them. Furthermore, Wolff could have prevented the release, to the press, securities analysts and SEC, of these fraudulent filings and reports. Wolff deliberately disregarded the impact that the misleading statements and omissions would have on the Homestore stock and the integrity of the market. For all of the above reasons, Wolff has acted with scienter.

133. At all times alleged, Wolff was the Chief Executive Officer and Chairman of Homestore who knowingly and intentionally participated in Homestore's scheme to defraud. Plaintiff's confidential sources characterize Wolff as a controlling person and said that Wolff had to "have his hands in everything." Wolff insisted on approving everything, and, thus, was in a position to know how revenue was being recognized. Wolff was also intimately involved in Homestore's statements to analysts, investors and the public. He was repeatedly quoted in Homestore's press releases as herein alleged, and consistently made

statements falsely hyping the value of Homestore's stock. Additionally, Wolff signed each of Homestore's misleading SEC filings during the Class Period.

134. As a common practice throughout 2000 and 2001, senior management at Homestore, including Wolff and Tafeen, were provided with computerized schedules called "Risk and Opportunities" schedules ("R & O"). According to Plaintiff's confidential sources, PWC saw these Risk and Opportunity schedules. Homestore's senior management knew that the sole purpose of these schedules was to gauge the quality of anticipated revenues for a quarter, and to determine what the shortfall would be in hitting the revenue target or "plug" as it was commonly and openly referred to by senior management. On these sheets, revenues were listed by their quality, and the senior management at Homestore commonly referred to some revenue as "good quality" and other revenues as "low" or "marginal" quality. Beginning in 1999, the custom developed that "good quality" revenue promised by Business Development executives, and in particular Tafeen, did not materialize causing Homestore to enter the last few days of a quarter scrambling to make the "plug." This "plug" was also referred to as making the "bogie." It was absolutely essential to senior management that they make their revenue targets, and therefore the "plug" or "bogie" was the revenue figure needed to satisfy Wall Street. Wolff and Tafeen were adamant that Homestore not be one of the e-business companies that did not meet its projections, and were obsessed with staying on the same revenue growth trends as their perceived peers such as eBay and Amazon.com.

135. According to Plaintiff's confidential sources, Wolff and Tafeen were the most involved in the discussions with AOL regarding the potential acquisition of Homestore, which was known within Homestore as the "Final Four." Part of the benefit to Homestore of this possible deal was that AOL would write off the third party vendor deals as part of the consolidation. Wolff was aware of this write off methodology. Wolff stood to pocket tens of millions of dollars from an AOL

acquisition, and he was even working on an employment agreement with AOL. Until the merger talks stalled in May 2001, the senior management at Homestore, including Wolff, considered the "Final Four" acquisition by AOL one way out of the fraudulent first quarter 2001 revenue deal.

136. During April 2001 and continuing into May 2001, Homestore's senior management was also trying to assess the costs involved in doing the triangular deals like the Q1 AOL deal. In addition to a schedule prepared by DeSimone which showed the impact on cash flow of these deals, Wolff presented a schedule at a May meeting attended by Tafeen, DeSimone, Giesecke and Shew, which showed the hidden leg of the triangular deals in order to assess how much it was costing Homestore. This schedule outlined the "round-tripping" of the funds that started with Homestore paying the third party vendors through AOL and back to Homestore. This schedule made the round-trip nature of the subject transactions apparent to anyone at the company who saw it, and depicted the link between the flow of money through the hidden leg. Homestore's senior management had accounting schedules which were reviewed at meetings attended by Wolff, Tafeen, Giesecke and Shew and that were known to others in the Business Development and Finance Department. These accounting schedules charted the cost of doing the triangular deals and depicted the costs of undertaking the triangular deals as "SAG carry-over costs." All those who saw the schedules, including Wolff, knew these were the amounts spent to buy the revenues which would not be coming back as a result of the AOL commission. These schedules demonstrated that Homestore's expenses were three times greater than its revenues from these deals. According to Plaintiff's confidential sources, at a meeting on or about May 21, 2001, Wolff reviewed those charts.

137. According to Plaintiff's confidential sources, Wolff was fixated with setting Homestore's revenue growth targets unrealistically at or above those set by other Internet companies. During April 2001, Wolff was setting Homestore's

revenue growth targets at or above those of eBay and Amazon.com. Wolff's growth targets set the stage for Homestore's fraudulent transactions.

138. According to Plaintiff's confidential sources, on or about April 11, 2001, Shew and Wolff had a lunch meeting. At this meeting Shew told Wolff that he was uncomfortable with the first quarter 2001 deal with AOL, and said that he did not feel right about facing PWC. Wolff replied by agreeing, but reassuring Shew that it was a one time deal, and that the AOL acquisition or a turn in the economy would save Homestore.

139. The company held an off-site meeting at the Cal Amigos Ranch on May 7, 2001, to discuss management issues and Wolff, Tafeen, Giesecke and Shew were going to hold a pre-meeting to discuss the need to do bogus deals to meet the Q2 expectations. Shew wanted Giesecke's support to confront Wolff and Tafeen on the issue. Shew, in particular, knew that the positive statements generated by Tafeen to Wolff about good revenues coming in did not usually pan out, and he wanted to call Tafeen on it.

140. The pre-meeting was supposed to be at 8 a.m. before the general executive meeting. Wolff was late to the pre-meeting, and the general group had already begun to assemble. Wolff, Giesecke, Tafeen and Shew met semi-privately in a sitting area off the main room. They first discussed the R&O schedule which showed that Homestore was now $40 to $50 million short of the "plug." All four top executives were fully familiar with these schedules and as a general business practice used them to gauge what had to be done to make the "plug" number. Shew and Tafeen did most of the talking and stressed the urgency of the shortfall as half the quarter had already passed. Wolff specifically asked Tafeen if there was any other source available for good revenues. Tafeen responded that there was AOL, Cendant and barter deals. Wolff wondered out loud: "Where do we get the revenue?" The entire focus of the discussion was how to buy revenue.

141. Wolff, Tafeen, Giescke and Shew all realized that in light of PWC's objection to Akonix and City Realty, they could not do "true barter" type transaction, which they had to keep at a level of 5% or below to avoid scrutiny. After a discussion of the rules relating to barter transactions, the Q2 AOL deal is discussed. By this point, it was apparent that the acquisition by AOL was not going through. They also realized that based on the comments made at the Audit Committee meeting in Q1 2001, any AOL deal would have to be booked on a net basis. Shew told everyone that as a result of raising the guidance and the fact that only net revenues could be booked, they would have to come up with a much larger number than last quarter.

142. The discussion then turned to Cendant, and a discussion ensued as alleged herein about not being able to document the back end of any Cendant deals. Both Shew and Giesecke reiterated that some type of deal would be done with Cendant, but a product had not yet been identified, and the back end could not be documented. The Cendant and AOL deals were the only ones that could meet the shortfall. At this meeting in the sitting room at Cal Amigos, the top four executives at Homestore explicitly discussed how to illicitly buy revenues in order to meet the "plug" and how to manipulate the documentation to avoid detection by PWC.

143. With respect to Homestore's round-trip transactions with AOL, Wolff knew that AOL and Homestore had issues to work out. On June 28, 2001, as AOL and Homestore were trying to resolve a dispute over who had the rights to $2 million in revenues before the end of the second quarter, Wolff wrote Colburn: "We need to get our cash now, just as you have gotten yours." According to Shew, Tafeen's proposed solution to the dispute was to have Wolff and Colburn together on a call.

144. On June 29, 2001, Wolff sent Colburn an e-mail stating: "Joe Shew was told that we would not be getting our cash immediately, and this is both unfair and will not be received well here." Also on June 29, 2001, Wolff wrote Colburn:

"David, Joe R. did call Joe Shew about the cash payment and said he would try to work this out, which is essential." Wolff sent Colburn another e-mail on June 29 stating that it is "absolutely essential" that they "resolve some key issues, and this is the very last minute for a mutually agreeable solution here."

145. On June 30, 2001, Wolff wrote Colburn stating: "As for the last item, my side has consistently maintained that this 2M or 2 million belongs to us."

146. In a July 1, 2001 e-mail from Colburn to Wolff, Colburn said that AOL was committed to working out issues with Homestore and moving the relationship to the next level. The next day, Wolff wrote Colburn: "David, fine. I would like to have a discussion with someone from your side this afternoon about the current arrangement and make sure we are on the same page before we invest more time in this process."

147. Further, a July 3, 2001 e-mail from Wolff to Ripp regarding this $2 million dispute shows a string of e-mails. These e-mails outline Homestore's position that the $2 million in dispute belonged to Homestore, not AOL.

148. According to Giesecke's trial testimony in *Wolff*, Homestore quarterly forecast meetings were held in August 2001. Wolff, Tafeen, Shew, and Giesecke attended the meetings. Despite discussions about reducing expectations and lowering guidance, Wolff did not consider reducing expectations to be an option.

149. Giesecke testified that, on September 4, 2001, a draft press release was circulated to Wolff. That draft press release reaffirmed guidance of Homestore revenues of $134 million for the third quarter of 2001. The press release reaffirming guidance at $134 million was publicly released on September 6, 2001.

150. Yet, based on the information available at that time, there was no basis for reaffirming guidance at that level of revenues. Giesecke testified that by September 6, 2001, Wolff and senior Homestore executives knew that Homestore's advertising business was performing below expectations. Therefore, in reaffirming

guidance without any basis for doing so, Homestore and Wolff misled the market and potential investors about Homestore's performance.

151. According to Giesecke, Wolff knew about Homestore's woeful performance prior to September 6 at the time of a July 25, 2001 conference call, but did not publicly disclose this information during the call. On July 25, 2001, after the market closed, Homestore announced its second quarter revenues of $129.3 million, falsely attributing the results to continued strong advertising traffic from its network of Web sites. Failure to disclose this information is another misrepresentation by Wolff that investors relied upon regarding Homestore's performance.

152. Shew elaborated on Giesecke's testimony:

> So we knew we wanted to reaffirm guidance soon, and we had discussions with the three of us [Shew, Wolff, and Giesecke] about the fact that we needed to stem the tide with the [falling] stock price, because the only way we were going to be able to get enough revenue for Q3 – and at this point we even had reservations about how we could get the revenue and potentially miss the numbers. In other words, we weren't going to deliver the number we thought, but let's deliver something south of it that's respectable and we will get just a little hammered by Wall Street.
>
> There was no way out. I mean we are in Q3 now. The house of cards is coming tumbling down.
>
> And we charted out effectively the scenarios that we needed to go through to make the quarter and survive thereafter. We needed to lay off over a thousand people. We needed to raise money. We needed to buy profitable companies that had a decent revenue.
>
> Q. What was the ultimate outcome?
>
> A. We reaffirmed guidance on September 6th [2001].
> (brackets added).

153. According to Giesceke, guidance was reaffirmed in an attempt to stabilize Homestore's stock price because it was under substantial pressure. Wolff and other senior Homestore executives hoped that the press release would alleviate fears that Homestore would not be able to meet its third and fourth quarter revenue targets. According to Tafeen, he and Wolff had discussed that **"if we [Homestore] missed our numbers, the company stock would get devastated**." The press release, and many others cited herein, misrepresented Homestore's financial prospects to stem any slide in Homestore's stock price in furtherance of a scheme to defraud investors.

154. On October 3, 2001, Homestore announced in a press release that it would not meet its third quarter expectations due to the September 11, 2001 attacks. According to Giesecke, Wolff reviewed the press release before it went out. Thus, Wolff knew that the press release misrepresented the reason for Homestore's poor third quarter performance – and for its apparent outstanding performance in the first and second quarters of 2001.

155. Of course, Homestore did not meet its third quarter revenue target. On November 1, 2001, Wolff publicly blamed the September 11, 2001 attacks for Homestore's poor performance during the quarter. In contrast, DeSimone, Giesecke and Tafeen all testified that September 11 had nothing to do with Homestore missing its target in the third quarter of 2001.

156. In further contradiction to Wolff's November 1 statements, Tafeen testified that there was not a single contract that failed to close after September 11 that was scheduled to close prior to that date. Nor was it true that Homestore missed its target because GMAC, Dorado and Wells Fargo failed to renew contracts. According to Tafeen, the impact of those deals was known before the third quarter began.

157. In short, the November 1 analyst call was full of misleading and false statements designed to hide the real reasons for Homestore's performance in the

first two quarters – its fraudulent transactions with Cendant, AOL, and L90. As Tafeen explains, Homestore was unable to use those same fraudulent transactions in third quarter as it had before, and it could not make up the revenue difference. That is why Homestore missed its third quarter target.

158. In his plea agreement, Tafeen states that during the first quarter of 2001, neither he nor any other executive of Homestore publicly disclosed the total revenue and advertising revenue that Homestore derived from round-trip deals. Tafeen testified that **all** the first through third quarter 2001 deals were **bogus**.

159. According to Plaintiff's confidential sources, once the internal investigation into Homestore's improper transactions began, Wolff met with various high ranking executives and officers of Homestore to determine what each of them would tell the internal investigators about Homestore's improprieties. According to Plaintiff's confidential sources, Wolff reportedly went so far as to say "the Homestore team must stick together."

160. While Wolff's actions were contrary to his corporate responsibilities, they were personally profitable. The massive number of options granted to Wolff created an incentive to inflate Homestore's stock price so that he could exercise his stock options and sell his stock at prices well above market value. According to Plaintiff's confidential sources, Wolff was obsessed with increasing the value of Homestore common stock in order to sell his shares at the highest possible profit. Moreover, Plaintiff's confidential sources recall that Wolff stated he wanted to "get more bang out of his buck" for his stock. On June 29, 2000, Wolff was granted 400,000 options with an exercise price of $26.56 which would vest monthly over four years. At December 31, 2000, Wolff had 549,999 exercisable and 350,001 unexercisable options.

161. On January 12, 2001, Wolff was granted an additional 900,000 options with an exercise price of $24.00 which would vest as follows: 20% become exercisable one year after the date of grant, subsequently vesting on a monthly

basis for the next 48 months. On December 31, 2001, Wolff had 743,749 exercisable and 1,064,586 unexercisable options. The massive grant of stock options created perverse conflicts of interest for Defendant Wolff relative to his fiduciary duties and obligations to the company and shareholders, including members of the Class.

162. The millions of options granted to Wolff at below market value created incentive for Wolff to inflate the common stock price of Homestore in an effort to assure that he would be able to sell his shares at a price above the exercise price for sizeable personal profits. According to Plaintiff's confidential sources, Wolff was obsessed with inflating the value of Homestore's stock and this is precisely what Wolff did. He participated in the wrongful conduct herein alleged, and had specific knowledge of the same as alleged in paragraphs above.

163. During the Class Period, Defendant Wolff sold 693,600 shares of Homestore stock, as set forth below, while in possession of material, adverse, non-public information. Wolff's stock sales are reflected in the following chart.

Date	Insider	Shares Sold	Sale Price	Proceeds
11/17/2000	Wolff	13,000	$29.12	$378,560.00
11/24/2000	Wolff	1,000	$28.50	$28,500.00
11/27/2000	Wolff	1,000	$28.50	$28,500.00
11/28/2000	Wolff	5,900	$26.70	$157,530.00
11/30/2000	Wolff	450	$25.00	$11,250.00
12/1/2000	Wolff	38,650	$25.62	$990,213.00
1/30/2001	Wolff	23,750	$30.14	$715,825.00
1/31/2001	Wolff	11,875	$30.01	$356,368.75
2/1/2001	Wolff	11,875	$29.44	$349,600.00
2/22/2001	Wolff	12,000	$30.00	$360,000.00
2/23/2001	Wolff	14,000	$29.51	$413,140.00
2/26/2001	Wolff	18,500	$29.34	$542,790.00
2/27/2001	Wolff	6,100	$29.53	$180,133.00

2/28/2001	Wolff	15,000	$29.59	$443,850.00
4/30/2001	Wolff	44,000	$32.46	$1,428,240.00
5/1/2001	Wolff	106,000	$32.49	$3,443,940.00
5/2/2001	Wolff	20,000	$3366	$673,200.00
7/31/2001	Wolff	47,000	$27.55	$1,294,850.00
7/31/2001	Wolff	9,000	$27.55	$247,950.00
8/1/2001	Wolff	57,000	$27.47	$1,565,790.00
		456,100		**$13,610,229.75**

164. Wolff sold stock on the following common "large trading days": April 30, May 1, May 2, July 31, and August 1, 2001. Wolff sold Homestore stock on each of these dates, with the exception of May 1, 2001. These "large trading days" occurred within days of Homestore's press releases announcing favorable financial results. Defendants' unusual trading volume combined with the conduct described herein establishes a strong inference of fraud throughout the Class Period.

165. The timing of these insider trades were designed to optimize the Former Individual Homestore Defendants' profits. According to Plaintiff's confidential sources, who personally benefitted from this scheme, company insiders had a quarterly "trading window" of approximately 30 days within which they could sell their shares. The trading window was established at the time of Homestore's initial public offering. Each trading window opened three days after the release of quarterly earnings reports, which usually occurred three to four weeks after the end of the quarter for which the report was released; the window closed 30 days before the start of the next quarter. In the first and second quarters of 2001, the Former Individual Homestore Defendants' insider trades were executed immediately after the window opened when Homestore's stock price was rising in response to the market's positive reaction to the company's glowing earnings reports.

166. For example, Homestore released its earnings report for the first quarter of 2001 on April 25, 2001. That release highlighted the company's record performance with the third consecutive month of cash profitability, with pro forma revenues for Q1 up 105 percent to $118.4 million from Q1 of 2000. Homestore's reported record profitability in what Wolff described as "a very difficult market," bolstered the price of its stock to benefit the Former Individual Homestore Defendants' insider trades. Indeed, one round of large trading days took place within days of that April 25th release, in late April and early May.

167. Similarly, Wolff's insider trades in late-July and early-August, 2001 immediately followed the company's July 25, 2001 earnings report, touting Homestore's record revenues and eighth consecutive quarter of strong results. Again, Homestore's reported record profits increased the price of its stock in what Wolff reiterated was a "difficult market climate" which further benefitted Wolff's insider trades.

168. Wolff participated actively during the course of and in furtherance of the scheme to defraud to recognize false revenues for Homestore and to conceal such information from the public. Wolff's acts were intended to promote the objectives of the scheme to defraud. Wolff knowingly and intentionally participated in Homestore's scheme to defraud. Because Wolff's conduct publicly misrepresented facts in the furtherance of a scheme to defraud, he is liable as a primary violator under § 10(b).

D. <u>FALSE STATEMENTS ISSUED BY HOMESTORE AND ANALYST REPORTS BASED THEREON</u>

169. Based on and with knowledge of their improper conduct described above, Homestore, with Wolff's participation and authorization, publically hyped its revenue growth to inflate the value of Homestore's common stock in furtherance of a scheme to defraud investors. This conduct started as early as 2000.

170. On January 13, 2000, *RealtyTimes* published an article entitled, "Peter Tafeen: Prince or Piranha of Homestore?" Tafeen is described as a "Master puppeteer who pulled many of the most important strings in manipulating Homestore's massive success." When asked why he does it, Tafeen replied, "We want to be the biggest and the best. I compare us not to other real estate companies, but to the greatest companies in the world. I look at UPS, GE, Microsoft, AOL and others and that is where we want to be."

171. On January 24, 2000, Homestore issued a press release reporting its record revenue and operating results for the fourth quarter and year ended December 31, 1999. Wolff commented on the report saying, "Our fourth quarter and 1999 operating results extend our strong growth trend at Homestore.com." The market reacted positively to the news, with Homestore's stock moving from $82.94 at the closing of January 23 to $96.50 at the closing of January 24, or a 16% rise. The market continued its positive reaction the next day, with Homestore's stock closing at $122.50 on January 25 for a 37% increase over the previous day close of $96.50. Thus, from January 23 to 25, Homestore's stock price increased over 47%.

172. On February 17, 2000, Homestore issued a press release announcing its strategic alliance with Smarthome.com, Inc., stating that Homestore made a 10% investment and entered into a multi-year marketing and distribution agreement with Smarthome.com.

173. On March 7, 2000, Homestore issued a press release announcing that it had entered into a 10-year strategic alliance with Budget Group, Inc. Under the alliance, Homestore would receive advertising in various media, provide 1,085,000 shares of Homestore common stock to Budget. The market reacted positively to the news, with Homestore's stock moving from $59.69 at the closing of March 7 to $61.25 at closing of March 8, or nearly a 3% increase.

174. On March 24, 2000, Homestore issued a press release announcing the expansion of its agreement with GMAC, providing that Homestore would receive an additional $10 million to support the expansion of GMAC's real estate, relocation and home finance units. This agreement added to the existing two-year $20 million agreement between Homestore and GMAC, entered into in November of 1999. The market reacted positively to the news, with Homestore's stock moving from $35.63 at the closing of March 23 to $47.81 at the closing of March 24, or a 34% rise. The market continued its positive reaction the next trading day, with Homestore's stock closing at $49.75 on March 27 for a 4% increase. From March 23 to 27, Homestore's stock price increased nearly 40%. In comparison to the rest of the market, which only increased 1.9% during this time period, Homestore looked to the public like a very successful company.

175. On April 7, 2000, Merrill Lynch analysts Henry Blodget and Kirsten Campbell reported that Homestore's current trading level (16 times Merrill Lynch's 2001 revenue estimate of $215 million) was attractive in relation to "other category killers such as eBay at 50X 2001 revenue estimates." Merrill Lynch analysts "believe that Homestore's fundamentals are strong and improving, and that the company will grow into a significantly higher valuation."

176. On April 11, 2000, Homestore issued a press release announcing that Allan Merrill was appointed as President of HomeBuilder.com, the engine for Homestore.com's "New Homes" site.

177. On May 1, 2000, Merrill Lynch's analysts Blodget and Campbell issued a report stating that the five-year deal between Homestore and AOL was "a major positive for Homestore." The deal reportedly had a total value of $90 million, $20 million of which was paid for in cash, and the rest paid in Homestore stock. The agreement required Homestore's stock to reach and maintain a price per share of $68.50 over three years. If this requirement was not met, Homestore would have to pay AOL $110 million in cash. Merrill Lynch analysts reported that

they thought the stock could reach $68 per share by the required date. The report forecast that Homestore's stock would beat Merrill Lynch's revenue estimate of $30 million and, therefore, would also beat their estimate of a loss of $0.17 per share. The report stated that "HOMS shares have been exceptionally weak as of late. We think [Homestore] shares are attractive, trading at 9x 2001 revenues." Merrill Lynch rated Homestore "Buy."

178. On May 3, 2000, after the close of the market, Homestore issued a press release announcing its purported "record" revenue for the first quarter of 2000, ending March 31, 2000. In pertinent part, Homestore stated:

> Revenues for the quarter increased 271% to $38.6 million over pro forma revenues of $10.4 million for the first quarter of 1999 and 38% over pro forma revenues of $28.1 million for the fourth quarter of 1999.
>
> Revenue growth in the first quarter was driven by both increased revenue from professional subscriptions as well as an increase in advertising revenue... **Growth in advertising revenue was primarily driven by increased sponsorships and expanded strategic alliances throughout the quarter.**
>
> "Our first quarter results confirm that Homestore.com's momentum continues to build," said Stuart Wolff, the company's chairman and chief executive officer. "The strong results across all of the key drivers of our business confirm that we are further extending our leadership position in this very large market." Wolff continued, "Based on the tremendous momentum that we have established, we anticipate the company will reach cash profitability earlier than expected." (Emphasis added).

179. Because Homestore knowingly and improperly recognized revenue from barter transactions, the buying of revenue, or round-trip transactions, Homestore's May 3, 2000 press release misrepresented the company's first quarter revenues.

180. Analysts and the market reacted positively to the misrepresentation in Homestore's press release. On May 4, 2000, in response to Homestore's after hours press release, Merrill Lynch analysts Blodget and Campbell wrote that, "Homestore.com reported a great quarter, easily exceeding estimates." The news that Homestore beat revenue predictions prompted Merrill Lynch to raise its

revenue predictions for 2000 from $139 million to $173 million and to raise the 2001 estimate from $215 million to $258 million. In addition, the report predicted that Homestore would achieve profitability two quarters earlier than expected, i.e., the company would be profitable in the first quarter of 2001. These increased revenue predictions led to a revised valuation for Homestore's stock. The company's losses were revised from a projected loss of $0.42 per share to a loss of $0.28 per share, and estimated earnings per share for 2001 were increased from $0.03 to $0.33. Blodget and Campbell stated that Homestore's "price objective remains $110, or 38X 01E revs."

181. On May 31, 2000, Homestore issued a press release announcing its joint marketing and advertising strategic alliance with Dorado.com. The two companies formed the two-year, multi-million dollar alliance, in which Dorado.com would pay Homestore for advertising and Homestore would gain equity in Dorado.com.

182. On June 12, 2000, Homestore issued a press release announcing its acquisition of Top Producer Systems, Inc. Homestore acquired Top Producer for approximately $24.2 million in Homestore common stock and cash. As a part of this deal, the founding shareholders of Top Producer were entitled to receive up to $16.2 million over the following four years if certain performance targets were met.

183. On June 19, 2000, Homestore issued a press release announcing a strategic financing and web marketing agreement with InvestorPlus.com. RealSelect, Inc., a Homestore subsidiary, invested in InvestorPlus.com and became a 10.5% equity partner. InvestorPlus would use the proceeds to develop its e-commerce platform. Additionally, the companies reached a comprehensive web marketing agreement, and a co-branded website would be launched later in the summer.

184. On July 14, 2000, a Merrill Lynch report stated that they expected Homestore's second quarter results, reported on July 19, 2000, to "easily exceed our estimates." The report stated that:

> 1. *Revenue.* We believe our revenue estimate is very conservative, up 5% sequentially and 185% year/year to $40 million. Our optimistic case calls for $48 million, helped by new deals announced this quarter. . . .
>
> 2. *Professional Subscribers.* We estimate 10,000 new subscribers, from 12,000 in 4Q for a total of 117,000. Revenue per average subscriber is down 8% to $208 from $225, though we believe this metric could be flat to up due to B2B revenue.
>
> 3. *Gross margin.* We expect it will be 73.4%, up from 72.6% in 1Q, for gross profit of $30mil.

185. The Merrill Lynch report stated, "We expect the company to easily exceed our estimates of a loss of $0.09 EPS [earnings per share] on $40.5 million of revenue." This forecast was based on Homestore's announcement of "many new 2-3 year guaranteed revenue deals." The report indicated that 60% of Homestore's advertising revenue came from similar 2-3 year contracts.

186. On July 19, 2000 Homestore released second quarter results in a press release entitled, "Homestore.com, Inc. Reports 252% Growth in Second Quarter Revenue," announcing that their revenue for the quarter had "increased." In pertinent part, Homestore stated:

> Revenues for the [second] quarter [which ended June 30, 2000] increased 252% to $50.2 million over pro forma revenues of $14.2 million for the second quarter of 1999 and 30% over revenues of $38.6 million for the first quarter of 2000. The company's gross profit margin improved 74% for the quarter, up from 63%, on a pro forma basis, for the second quarter of 1999 and from 73% for the first quarter of 2000. Pro forma net loss for the quarter was $2.8 million, or $0.03 per share. That compares to a pro forma net loss of $20.9 million, or $0.36 per share, for the second quarter of 1999 and $10.0 million, or $0.14 per share, for the first quarter of 2000.
>
> On a GAAP basis, the company's revenues for the quarter were $50.2 million, compared to $11.0 million for the second quarter of 1999 and $38.6 million for the first quarter of 2000. Net loss for the quarter was $24.7 million, or $0.31 per share, compared to $18.3 million, or $0.75 per share, for the second quarter of 1999, and $29.2 million, or $0.39 per share, for the first quarter of 2000.

> **Increased revenue from both professional subscriptions and advertising drove overall revenue growth in the second quarter.** Revenue growth from professional subscriptions was primarily due to an increase in the number of professionals on the Homestore.com™ family of web sites. Professional subscriptions rose to almost 122,000 at June 30, 2000, representing increases of 64% and 14%, compared to totals at June 30, 1999 and March 31, 2000, respectively. **The increase in professional subscriptions included the Realty Executives International, Inc. corporate sponsorship agreement signed in May. Growth in advertising revenue was primarily driven by an expansion in sponsorships and strategic alliances during the quarter.**
>
> Site usage also grew substantially during the second quarter. For April and May 2000, the monthly average number of unique users visiting the Homestore.com network rose to 3.6 million, a 51% increase over the second quarter of 1999 and a 25% increase over the first quarter of 2000. (1) During April and May of 2000, each unique user spent an average of 26.1 minutes per month on the network, a 17% increase over the second quarter of 1999 and consistent with the first quarter of 2000. (2) Page views were 626 million for the quarter and 1.2 billion homes were viewed on the Homestore.com network during the quarter, bringing the cumulative number of homes viewed since the company's inception to 5.9 billion.
>
> "Another excellent quarter of execution by our team," said Stuart Wolff, the company's chairman and chief executive officer. "We are furthering our leadership position to both consumers and professionals as we build out the online home and real estate marketplace." Wolff added, "Based on the strength of our financial performance, we expect the company to reach cash profitability in the fourth quarter this year, which will place Homestore.com in an elite group of Internet companies." (Emphasis and brackets added).

Because Homestore knowingly and improperly recognized revenue from barter transactions, the buying of revenue, or round-trip transactions, Homestore's July 19, 2000 press release misrepresented the company's revenues.

187. The release of this July 19, 2000 statement caused Homestore's stock price to soar. The following trading day, Homestore's stock price increased by more than $7 to $38.50. This amounted to a 25% increase in the value of the stock. However, as alleged below, according to Plaintiff's investigation, Homestore's July 19, 2000 press release was materially misleading because Defendants knowingly overstated the on-line advertising revenue it received during the second quarter of 2000. Certain advertising transactions, that were recognized as revenue, should not

have resulted in revenue recognition because they were barter transactions, the buying of revenue or "round-tripping."

188. Basing their reports on Homestore's July 19, 2000 deceptive announcement, several analysts issued reports advising the investing public to buy Homestore common stock. Among those analysts were Robertson Stephens analysts' Michael Graham and Jay P. Leupp, who on July 20, 2000, issued a report entitled "HOMESTORE.COM: Strong Q2 results. Profitability coming faster than expected. Raising estimates substantially. Buy Rated." Robertson Stephens reported that Homestore's revenue upside was driven by strong demand for Homestore's professional services and "strong online advertising sales targeted toward the home buying demographic." In addition, Robertson Stephens reported that:

> We believe this is only the beginning of our ability to raise estimates and expectations for [Homestore stock]. We view the company as occupying a central and leading position in one of the largest sectors of the U.S. economy. We believe the company's opportunity is open-ended. Buy rated.

189. Similarly, on July 20, 2000, Merrill Lynch analysts Blodget and Campbell, in a report entitled "Blowout 2Q: Raising Estimates and accelerating Profitability, Again–Part 2," favorably reported on Homestore's stock:

> Homestore.com reported great 2Q results. We are raising estimates (accelerating profitability by 1 quarter to 4Q) and maintaining rating. We maintain high confidence in the company's prospects and reiterate our Buy rating.
>
> 2000E revenue goes from $174mm to $204mm, 2001E from $259mm to $300mm. 2000E EPS loss goes from d$0.28 to d$0.16, and 2001E from earnings of $0.33 to $0.35. We believe there is still significant upside to the new [estimates].

Merrill Lynch's report then went on to say that Homestore's price to EPS was "very attractive" for a "sector leader with continued strong growth." Merrill Lynch gave Homestore a quarter grade of "A" for the second quarter of fiscal year 2000.

190. A third report was issued on July 20, 2000 by Chase H&Q analysts Genni Combes and Matthew Gustke, who stated that Homestore's second quarter

2000 results were “significantly above expectations.” The report entitled “Very Strong Q2 for Homestore. Profitability to arrive in Q4,” reported that Homestore’s revenue growth of 252% year per year was driven by an ad/sponsorship increase of roughly 494% year per year. The report projected that Homestore would achieve profitability in the fourth quarter of 2000, or earlier than their previous estimate of profitability for the first quarter of 2001. The report adjusted revenue expectations up by $30 million to $201 million and reduced EPS loss assumptions. In addition, Chase H&Q increased Homestore’s 2001 forecasted earnings to $285 million and stated that there was “significant room for upside.” The report stated that the addition of large ASP customers and the launch of an AOL channel in the third quarter had “the potential to act as near-to medium-term catalysts for shares of [Homestore].”

191. UBS Warburg analysts John Stanley and Marisol Myung issued their report on July 21, 2000, stating that “Homestore’s dominance of traffic in the home space is central to its drive to produce revenues from advertisers on its content-laden vortal [virtual portal], and from home professionals in its emerging role as the leading vertical ASP.”

192. On August 4, 2000, Homestore filed its June 30, 2000 financial results with the SEC on a Form 10-Q. In its 10-Q Homestore reiterated the financial results reported in its July 19, 2000 press release. Homestore represented that the financial statements were prepared in accordance with GAAP, when, in fact, as alleged below, the quarterly and annual financial statements during the relevant period were not prepared in conformance with GAAP, nor were the audits performed in accordance with GAAS.

193. Homestore’s misrepresentation that its financial results were presented in accordance with GAAP misled readers into believing that they could rely on how the company’s financial condition was presented. Therefore, the filing of the

August 4, 2000 10-Q deceived the investing public about Homestore's financial condition in furtherance of a scheme to defraud investors.

194. On August 17, 2000, Merrill Lynch analysts Blodget and Campbell reported that, based on their talks with Homestore that week, they believed Homestore was on track to report strong results for the third quarter of 2000. In addition, they raised revenue estimates $6 million to $210 million for fiscal year 2000 and increased profit estimates $20 million to $320 million for fiscal year 2001. Merrill Lynch emphasized that these adjusted estimates were "still conservative" and reported that they expected Homestore to post its first profit of $0.01 per share in the fourth quarter of fiscal year 2000. Merrill Lynch called Homestore "a sector leader with continued strong growth."

195. On August 24, 2000, Robertson Stephens analyst Michael Graham published a report entitled "HOMESTORE.COM: We Believe Business is Going Great, and Getting Stronger with AOL Channel, We See Open-Ended Opportunity with Transaction Platform." Graham wrote that analysts at Robertson Stephens believed that "business is tracking ahead of expectations with catalysts in the next few months." Graham reported that Robertson Stephens "continue[d] to believe our estimates are conservative." Accordingly, Robertson Stephens increased third quarter revenue projections by 6% to $53.0 million and indicated that "revenue upside could drive [Homestore stock] to profitability earlier than previously expected." The report indicated that there were a number of business catalysts approaching that would likely lead to additional profits for Homestore:

a. An increase in visits to Homestore's site to over 4 million unique users.

b. The expected launch of Homestore's home channel on AOL in September (the report indicated that the launch of the AOL home channel would likely double the traffic across the Homestore network).

c. Homestore's Realtors Electronic Transaction Platform, allowing the entire home buying process to occur over the internet,

> "represent[ed] an open-ended opportunity targeting $100b in fees generated by home sales."

Given these developments Graham concluded that:

> The stock is beginning to recover following market and lock-up related weakness. With impending profitability and revenue multiple substantially lower than comparable companies, we recommend buying [Homestore stock] ahead of what we view as impending catalysts.

196. On September 14, 2000, Merrill Lynch analysts Blodget and Campbell added their endorsement to Homestore's acquisition of The Hessel Group and stated that they "continue[d] to believe that the company is on track to meet or beat our 3Q estimates of $58mm in revenue and an adjusted EPS loss of $0.01." Merrill Lynch reiterated their Buy rating for Homestore's stock.

197. On October 4, 2000, Homestore announced the launch of its content on AOL's House & Home channel, giving AOL members direct access to Homestore's products and services.

198. On October 5, 2000, Merrill Lynch analysts Blodget and Campbell reported that they expected Homestore's third quarter results to "easily exceed our estimates." In addition, Merrill Lynch stated that they "believe the fundamentals remain strong, and maintain [their] buy rating." The report stated that Merrill Lynch's revenue estimate was "very conservative," that revenues could be seen as high as $63 million, and revenue per average subscriber "would be up 5% to $258 from $245." Merrill Lynch stuck to its expected EPS net loss forecast and stated that they expected Homestore to post a $0.01 adjusted EPS profit in the fourth quarter.

199. Beating all analyst expectations, Homestore announced on October 19, 2000, that it had achieved net profitability ahead of schedule during the third quarter. This was a turning point for the company, since few Internet companies had achieved profitability. Indeed, even among non-Internet companies, becoming profitable was considered a pivotal event. In addition, Homestore announced that

its net revenues exceeded expectations, netting more than $370 million. The press release, entitled: "Homestore.com, Inc. Reports Net Income Cash Profitability," announced Homestore's supposed "continued growth" and first-time "profitability." In pertinent part, Homestore stated:

> Homestore.com, Inc. joined the ranks of the small group of cashflow-positive publically traded dot-companies in the third quarter, achieving net income cash profitability of $554,000 for the period. The company today reported financial results for the quarter ended September 30, 2000, with continued growth in revenues, professional subscribers and unique visitors to its online home and real estate network, and over $370 million in cash on its balance sheet.
>
> "This quarter we joined an elite group of Internet companies that have achieved cash profitability," said Stuart Wolff, Homestore.com's chairman and chief executive officer, "and to accomplish this with such continued strong top-line growth, not only demonstrates the strength of our financial model, but also highlights the power of our strategic positioning and the continued execution of our management team."
>
> "The tremendous value of a central, online home and real estate marketplace is becoming apparent to more consumers and real estate professionals every quarter," Wolff added. "Our network has aggregated the largest audience of consumers and home professionals on the Internet today which serves as a powerful platform to further extend our subscription, advertising and transaction services and products," said Wolff.
>
> The company said revenues for the third quarter increased to $62.2 million, a 201% increase over pro forma revenues of $20.7 million for the third quarter of 1999 and a 24% increase over revenues of $50.2 million of the second quarter of 2000. The company's gross profit margin improved to 74.0% for the quarter as compared to 69.3%, on a pro forma basis, for the third quarter of 1999 and 73.5% for the second quarter of 2000. Pro forma net income for the quarter was $544,000, or $0.01 per share. That compares to a pro forma net loss of $16.8 million, or $0.25 per share, for the second quarter of 2000.
>
> On a GAAP basis, the company's revenues for the quarter were $62.2 million, compared to $18.6 million for the third quarter of 1999 and $50.2 million for the second quarter of 2000. The net loss for the quarter was $27.1 million, or $0.33 per share, compared to a net loss of $34.2 million, or $0.65 per share, for the third quarter of 1999, and $24.7 million, or $0.31 per share, for the second quarter of 2000.
>
> Increased revenue from both professional subscriptions and advertising drove overall revenue growth for the third quarter of 2000 over the second quarter of 2000. The growth in revenue from professional subscriptions was due to an increase in the number of professionals on the Homestore.com™ family of web sites, as well as an increase in the average price per subscription. Professional

> subscriptions rose approximately 131,000 at September 30, 2000, representing increases of 54% and 7% compared to totals at September 30, 1999 and June 30, 2000, respectively. Renewals also contributed to the increase in professional subscriptions with the renewal rate remaining consistent at approximately 70%. Growth in advertising revenue was primarily driven by an expansion in sponsorships and strategic alliances during the quarter.

200. Market analysts took quick notice of Homestore's reported success. On October 19, 2000, Bloomberg News reported on Homestore's press release, stating that Homestore's "revenue more than tripled in the third quarter because of more subscriptions and advertising." (Emphasis added). According to the article, Wolff attributed Homestore's success to "a combination of top-line growth together with bottom line operating leverage."

201. On October 20, 2000, Merrill Lynch analysts Blodget and Campbell maintained their "Buy" rating for Homestore's stock. Blodget and Campbell raised revenue predictions for Homestore for 2000 to $219 million from $210 million and 2001 estimates to $329 million from $320 million. Expected per share losses were reduced from $0.16 to $0.13 and 2001 estimated profit per share was raised from $0.35 to $0.37. The report indicated that there was "still significant upside in the new [estimates]." Regarding the company's future outlook, the report stated:

> While valuation, volatility, and weakness in technology stocks continue to be risks, we believe [Homestore stock] will perform well from this level for the next year or two. The company has clearly demonstrated its leadership in the category, the leverage of the model, continued strong sequential revenue growth, and management's ability to execute above expectations.

202. Later that same day, Merrill Lynch analysts Blodget and Campbell reported that Homestore's "[a]d revenue grew 32% seq. to $29.2 mm, well ahead of our $25.5mm estimate, especially good news in the current environment."

203. On October 27, 2000, Homestore and Cendant announced in a joint press release that Homestore had signed an agreement on October 26, 2000 to acquire Move.com from Cendant Corporation. The press release and the Investor

Conference Call of the same day, in which Smith participated, omitted Cendant's contribution to RETT as part of the Move.com deal. The market reacted positively to the news, moving from $28.95 at the closing of October 26 to $37.94 at the closing of October 27, or **an increase of 31%**.

204. On November 9, 2000, Merrill Lynch analysts Blodget and Campbell reported on Homestore's "Impressive Analyst Day," stating:

> Homestore [would] be one of the internet success stories over the next few years, and has the opportunity, leadership, technology and industry support to transform - and be at the center of - the home buying transaction.

Blodget and Campbell reported that Homestore defined its potential market as about $145 billion and that Homestore had only tapped into 10% of that market to date.

205. On January 11, 2001, Homestore issued a press release stating that its shareholders, in conjunction with the company's proposed acquisition of Move.com, had approved the issuance of approximately 26.3 million shares of common stock in the company. Homestore announced that the acquisition was expected to close as soon as regulatory hurdles could be overcome. In the press release, Wolff stated:

> We are eager to get to work to further expand the most vibrant and comprehensive online home and real estate marketplace possible for the benefit of both consumers and professionals. We appreciate our shareholders' confidence and are looking forward to continued momentum.

The acquisition of Move.com was touted by Homestore as providing "a variety of synergistic opportunities resulting from the merged assets, as well as increasing financial benefits from the economies of scale the transaction will make possible."

206. On January 16, 2001, the *East Bay Business Times* published an article entitled, "Homestore buys iPix assets." That same day, Homestore issued a press release entitled, "Homestore.com, Inc. Acquires Key Assets from iPix For Residential Real Estate Virtual Tours." The acquisition included a license to sell

iPix's Virtual Tour Technology and existing iPix sales contracts. The purchase price was reported as $12 million in cash. The market reacted positively to the news, with Homestore's stock moving from $24.00 at the closing of January 15 to $25.25 at the closing of January 16, or a 5% increase.

207. On January 25, 2001, Homestore issued a press release announcing Homestore's fourth quarter results. Wolff described the fourth quarter as "another quarter of strong revenue growth and cash profitability at Homestore.com." The company's reported net income for the fourth quarter of $3.3 million, or $0.04 per share, far exceeding all analysts' estimates. This was a 400% increase in income per share over the $0.01 income per share for the third quarter of 2000.

208. On January 25, 2001, Homestore issued a press release entitled "Homestore.com, Inc. Reports 27% Sequential Revenue Growth and Cash EPS of $0.04 for Fourth Quarter of 2000," announcing Homestore's alleged "second quarter of cash profitability." In pertinent part, Homestore stated:

> Homestore.com, Inc., the leading supplier of online media and technology to the home and real estate industry, today reported revenue of $79.0 million and net income, excluding certain non-cash items, of $3.3 million, or $0.04 per share, for the fourth quarter of 2000, the company's second consecutive quarter of cash profitability. Homestore.com ended its first full year as a publically traded company with 213% year-over-year growth in pro forma revenues, substantial increases in professional subscribers and unique visitors to its online network, and more than $345 million in cash on its balance sheet.
>
> "It is a pleasure to report another quarter of strong revenue growth and cash profitability at Homestore.com," said Stuart Wolff, the company's chairman and chief executive officer. "We have accomplished a great deal in the past 12 months, including the announcement of two exciting transaction platforms, the ongoing build-out of our ASP strategies and long-term agreement with AOL that gives tremendous exposure to our consumer content. All of this is a great tribute to the hard work and execution of the entire Homestore.com team as we look forward to another strong year of growth in 2001," he added.
>
> The company said revenues for the fourth quarter increased to $79.0 million, up 182% from pro forma revenues of $28.0 million for the fourth quarter of 1999, and up 27% from revenues of $62.2 million for the third quarter of 2000. The company's gross profit margin was 73% in fourth quarter compared to a pro forma gross profit margin of 71% in the fourth quarter of 1999, and 74% in the third quarter of

> 2000. Pro forma net income for the fourth quarter was $3.3 million, or $0.04 per share. That compares to pro forma net loss of $16.2 million, or $0.23 per share, for the fourth quarter of 1999 and pro forma net income of $554,000 or $0.01 per share, for third quarter of 2000.
>
> Subscriptions generated approximately 52% of total revenues in the quarter. The improvement was due to an increase in the number of professionals on the Homestore.com™ family of Web sites as well as an increase in the average revenue per subscription, which was primarily due to increased sales of ASP products, most notably Top Presenter 2. The number of professional subscriptions rose to approximately 145,000 at December 31, 2000, an 11% increase from the total at September 30, 2000. Renewals also contributed to the increase in professional subscriptions with the renewal rate consistent with prior quarters at approximately 70%.
>
> Advertising produced approximately 48% of total revenue in the quarter. Growth in advertising revenue was primarily driven by an increase in advertising and sponsorship deals during the quarter, including Bank of America, Budget Group, and Kodak. Also contributing to the increase in advertising revenue was the company's expanded relationship with America Online, in which AOL sold advertising on the company's behalf.
>
> The average monthly number of unique users visiting the Homestore.com network rose to approximately 4.3 million, up 102% from the fourth quarter of 1999 and up 3% from the third quarter of 2000. Each unique user spent an average of 19.7 minutes per month on the network, up 11% from the fourth quarter of 1999, and down 13% from the third quarter of 2000. The decreases in average minutes per visit and page views from the third quarter of 2000 were consistent with the seasonally slower fourth quarter. One billion homes were viewed on the Homestore.com network during the period. The cumulative number of homes viewed since the company's inception is now approximately 8.1 billion.

209. The market reacted positively to this news. When trading resumed on January 26, 2001, the day after the dissemination of the above press release, the price of Homestore common stock rose $3.1875, or 11%.

210. In response, Salomon Smith Barney ("Salomon") analyst Tim Albright raised Salomon's earnings estimates. Salomon described Homestore's fourth quarter as "extremely strong" and stated that "this is a strong story that keeps getting stronger." Salomon noted that the reported $79 million in revenues (versus their estimate of $68 million) was up 27% and operating profit of 4% exceeded their estimate of 1%. Salomon reiterated its "2S Outperform rating and $36 target

price." The report ebulliently stated that "[t]his is an extremely strong Internet story." Advertising revenue was expected to exceed Salomon's estimate of $32.5 million, Homestore reported advertising revenue of $37.5 million. This rise of $5 million was attributed to "an expansion in sponsorships and strategic alliances during the quarter." Homestore's management reportedly boasted that "international expansion opportunities" would provide "a source of revenue upside."

211. In its January 26, 2001 report entitled, "Fulfilling the Promise of the Internet," Salomon stated:

> Homestore represents the original vision of an Internet company fulfilled. This is a high margin, fixed-cost business model that has seized an early leadership position, and extended it into complete dominance over a sizeable category that is perfectly suited for the medium. The result is a rapidly growing, industry-transforming, profitable business. Our $36 price target, which is likely conservative, is a PEG EPS multiple on out 2001 estimate of $0.38. We believe that both numbers have room to rise.

212. That same day, Merrill Lynch analysts Blodget and Campbell reported that they were "raising estimates again (!)" in light of Homestore's first profitable quarter. Blodget and Campbell described Homestore's reported revenues as "a very strong quarter in a weak market." Merrill Lynch raised 2001 revenue estimates "from $329mm to $350 mm (+53% y/y)" and raised expected earnings per share from $0.37 from $0.40. Merrill Lynch's 2002 estimates for revenue went to $468 million in revenue and $0.72 earnings per share.

213. The Merrill Lynch report touted "amazing 30%" sequential growth in advertising up to "$37.9mm (in a flat ad market)." The report attributed growth in advertising revenue to "a Fortune 500 advertiser base, increased inventory from the AOL deal, and an excellent user demographic." According to the report, professional subscriber revenue "grew 25% seq. to $41.1 million, driven by 1) 14,000 new subscribers, well ahead of our 8,000 estimate, and 2) a 14% sequential increase in revenue per average subscriber..."

214. On January 26, 2001, *The Industry Standard* published a report entitled, "Homestore Earns Big in a Down Season," in which Stuart Wolff explained why Homestore was doing so well, specifically in ad revenue, while other Internet companies are missing earnings or filing for Chapter 11 bankruptcy protection. Wolff stated, "I think the fourth quarter says a lot about us as a company. In a difficult quarter we actually accelerated our revenue growth. There are probably only five other tech companies that were able to do that." The article touts Homestore's unique ability to increase its advertising revenue with contract wins from Bank of America, Kodak and Budget Group in an otherwise poorly performing market. The author also noted that Homestore's subscription revenue, comprising more than half of its total revenue, enjoys a 70% renewal rate.

215. On February 5, 2001, Merrill Lynch analysts Blodget and Campbell reported that they were raising 2001 and 2002 revenue estimates for the second time within a two week period. The report stated:

> Homestore reported blow-out 4Q numbers two weeks ago. At the time we raised estimates and said we believed our numbers were still conservative. After working through the numbers in more detail, we are further increasing estimates.

Blodget and Campbell increased the 2001 revenue estimate "from $350mm to $355mm" and the earnings per share estimate "from $0.40 to $0.43 (untaxed)." The 2002 revenue estimate was increased "from $467mm to $477mm" and earnings per share "from $0.72 to $0.77 (untaxed)." The report stated that there was still upside to the stock's current price of $29 and predicted that the 2001 earnings per share could climb as high as "$0.50-$0.75 (untaxed)" and "$1.00 or more in 2002." The report maintained Merrill Lynch's "Buy" rating for the stock. The next day the market reacted positively to the report, with Homestore's stock moving from $28.63 at the closing of February 5 to $30.13 at the closing of February 6, or a 5% increase.

216. On February 20, 2001, Homestore issued a press release and announced that it had completed its acquisition of Move.com from Cendant Corporation. The acquisition was vaunted as a source of additional "revenue streams and cost synergies."

217. On February, 20, 2001, Merrill Lynch published a bulletin supporting the Move.com acquisition and touting Homestore's dominance in the Internet real estate business. Merrill Lynch gave Homestore a glowing endorsement regarding Homestore's expected earnings and future earnings potential. Merrill Lynch's report stated in pertinent part:

> We regard Microsoft's retreat from the mortgage technology business as more of a psychological boost than a real change in the competitive landscape (we believe Homestore had a significant lead). Since one persistent investor concern has been "the Microsoft threat," however, we view this as positive for the stock.
>
> Our 2001 standalone company estimates are revenue of $355 million (+55%) and EPS of $0.43 (untaxed). 2002E is revenue of $477 million (+35%) and EPS of $0.77 (untaxed).
>
> At $34, [Homestore stock] is trading at about 77X 2001E EPS and 43X 2002E. We expect long-term EPS growth of 50%-75%, so this is still a PEG ratio of less than 1.0X. Furthermore, we believe there is still upside. We believe the company could earn 2001E EPS of $0.50-$0.75 including Move.com and $1.00 or more in 2002. We reiterate our Buy rating.

The Move.com acquisition was interpreted by Merrill Lynch as a positive for Homestore and its stock because it was viewed as: "1) accretive, 2) eliminates major competitor, 3) gains access to 25% of industry brokers and transactions, 4) improves real listings business." Merrill Lynch likened Homestore to the little engine that could and stated that "[a]s the competition falls to the wayside, Homestore continues to plod along, securing its spot as the dominant online real estate player."

218. According to a Homestore report, the company believed that the acquisition would raise 2001 revenue to $443.0 million from $349.8 million and earnings per share to $0.44 from $0.38. The company also stated that 2002

revenue would increase to $600.3 million from $472.3 million, and earnings per share would accrue to $0.84 from $0.73. A section of the report entitled, "Investment Thesis and Valuation" boasted about the value added to Homestore stock by the Move.com acquisition:

> Homestore represents the original vision of an Internet company fulfilled. This is a high margin, fixed-cost business model that has seized an early leadership position, and extended it to complete dominance over a sizeable category that is perfectly suited for the medium. The result is a rapidly growing, industry-transforming, profitable business. Raising stock price target to $42, on growth-based EPS multiple of 50x or 2002 estimate of $0.84. We believe that both numbers have room to rise. Our ratings improvement from 2S (Speculative) to 2H (High Risk), reflects an improvement in the risk profile with respect to the original DOJ investigation. The end result of this acquisition is that Homestore emerges with a firmer ownership on a very attractive market.

219. On February 21, 2001, Merrill Lynch analysts Blodget and Campbell again raised revenue estimates in light of Homestore's announced acquisition of Cendant's Move.com website. Blodget and Campbell raised 2001 revenue estimates "to $453mm from $355mm" and earnings per share (untaxed) "to $0.46 from $0.43." The report indicated that these estimates were "slightly ahead of management's forecast."

220. On March 14, 2001, Homestore issued a press release entitled, "Kodak, Homestore.com, Inc.- Operator of Realtor.com - To Provide Real Estate Professionals With High Quality, Internet Imaging Services." This release announced a three-year agreement intended to accelerate the growth and use of digital imaging by real estate professionals on the Internet. Under this agreement, Kodak would purchase targeted sponsorship impressions across the Homestore family of websites. The market reacted positively to the news, with Homestore's stock moving from $20.31 at the closing of March 14 to $21.63 at the closing of March 15, or a 6% increase.

221. On March 27, 2001, WR Hambrecht + Co announced that it would commence coverage of Homestore stock. WR Hambrecht + Co analyst Derek

Brown cited "Homestore.com's category leadership, profitable business model, and attractive valuation" as reasons for WR Hambrecht + Co's "Buy" rating and target price of $40 for Homestore's stock. Brown wrote:

> In our opinion, Homestore.com is rapidly emerging as a key component of the 21st century residential real estate industry. The company's market-leading Web portal is a valuable consumer resource and an efficient and cost effective marketing channel for real estate professionals, service providers, and manufacturers. When coupled with its rapidly expanding suite of professional technology solutions, Homestore.com has the appearance of an 'operating system' for the home- and real-estate-related industries.

The market reacted positively to the report, with Homestore's stock moving from $24.69 at the closing of March 26 to $25.94 at the closing of March 27, or a 5% increase.

222. On March 28, 2001, Prudential Securities analyst, Mark J. Rowen, in an article entitled "Homestore.com is Building a Fortress–We are initiating Coverage With a Strong Buy Rating," reported that Homestore's partnerships with key industry players, including "the National Association of Realtors; The National Association of Home Builders, a majority of multiple listing services ("MLS"), and a number of key brokerage firms," would "help Homestore build a fortress around its business, and help it sustain a competitive advantage." Rowen wrote that "patient investors will be rewarded" for buying Homestore's stock as "operating margins and EPS increase rapidly over the next 12-24 months." Homestore's stock was given a twelve-month price target of $32. The report described Homestore's revenue sources as "industry subscribers (for example, real estate agents, brokers, and homebuilders), advertisers hoping to reach a highly targeted audience, transaction fees, and the licensing of its online software platform." (Emphasis added). The article posited that because users can access more listings on the Homestore site they will be more likely go there to look for homes, and that "a greater number of buyers attract a greater number of sellers, while a wide choice of home listings from the sellers attract additional buyers." Rowen concluded that

"Homestore may have formed the basis for a sustainable competitive advantage with its MLS agreements." In addition to lauding Homestore's business model and its long term growth potential, Rowen's article was very positive about growth and increases in revenues from subscriber fees.

223. Rowen's article made further positive statements about Homestore's business potential: (i) the company was expected to improve its margin, while rapid revenue growth would continue; (ii) the site is well organized to provide a full range of real estate services; (iii) the company has the opportunity to expand revenue significantly in the long-term; (iv) Homestore is developing Internet-based application platforms with equity partners NAR, FannieMae, GMAC, Verisign, and ReformsNet and with five of the largest relocation services companies in the United States that will have revenue impact in the near future; (v) Homestore is expanding into the international market; (vi) Homestore is a more effective platform for home searches than competing Internet realtors because it offers more listings on its site than other sites, this advantage is a result of its relationship to NAR and various MLSs across the country; and (vii) increased subscription fees, higher-margin advertising, and the company's ability to sell more products to subscribers will lead to improved margins. The article indicated that Homestore's "advertising revenue per 1,000 page views was $68.98 in the fourth quarter, unusually high for Internet advertising, owing to sponsorship agreements not dependent on page views."

224. On April 2, 2001 Homestore filed its annual results for the year 2000 in its Form 10-K, representing that the financial statements were prepared in accordance with GAAP and had been audited in conformance with GAAS. Homestore's 2000 Form 10-K reiterated the financial results set forth in the January 25, 2001 press release. However, as alleged below, these results were materially false and misleading because Homestore overstated its online advertising revenues by $36.4 million. Certain advertising transactions should not

have been recognized as revenue because they were barter transactions, the buying of revenue or "round-tripping."

225. Homestore's misrepresentation that its financial results were presented in accordance with GAAP misled readers into believing that they could rely on how the company's financial condition was presented. Independent of that deceptive conduct, because Homestore knowingly and improperly recognized $36.4 million in revenue from barter transactions, the buying of revenue, or round-trip transactions, Homestore's filing of its 10-K for the fiscal year 2000 misrepresented the company's revenues in furtherance of a scheme to defraud investors.

226. On April 3, 2001, Salomon analyst Tim Albright wrote an article entitled, "HOMS: Strong Company, Complex Story; Discipline Required," stating that revenue and EPS as of March 2001 "have much upside potential, due to guidance coming out of the Cendant deal." Albright noted Homestore's significant "reliance on advertising." Albright indicated that Salomon had "110% confidence in Homestore's ability to make its Q1 numbers" and stated that they believed that Homestore is a "powerful, profitable company." Salomon recommended that investors buy Homestore stock when it dipped under $20 per share.

227. On April 10, 2001, Salomon analyst Albright, in an article entitled "Consumer e-Commerce Survivors Should Meet or Beat Q1. Online Consumer Lives," boasted that its group of "consumer e-commerce survivors... should meet or beat Q1 estimates" and that they had "upside against published estimates." Salomon predicted that its estimate that Homestore would make revenues of $107 million had "$8 million to $13 million in revenue upside and $0.02 to $0.03 in EPS upside."

228. On April 10, 2001, Homestore issued a press release entitled, "Bank of America and Homestore.com, Inc. Announce Multi-Year Strategic Agreement," announcing the launch of a new online homeowner service.

229. The market reacted positively to the analyst reports and news, with Homestore's stock moving from $23.22 at the closing of April 9 to $28.53 at the closing of April 10, or nearly a 23% increase.

230. On April 25, 2001 Homestore issued a press release entitled, "Homestore.com, Inc. Reports Strong and Steady 1st Quarter Growth; Cash Profitability, Strong Revenue Growth Market Record Performance." In pertinent part, Homestore stated:

> Homestore.com, Inc., the leading supplier of online media and technology to the home and real estate industry, today reported pro forma revenue of $118.4 million and pro forma net income, excluding the effects of certain non-cash items, Move.com acquisition-related charges and write-down of certain investments, of $4.0 million, or $0.04 per share, for the first quarter of 2001, the company's third consecutive quarter of cash profitability.
>
> **"I'm extremely proud of the Homestore.com team for posting a very strong quarter in a very difficult market," said Stuart Wolff, chairman and chief executive officer. "I'm also very pleased with the speed at which we have integrated the Move.com acquisition while continuing our track record of strong operational performance."** (Emphasis addded).
>
> The company said pro forma revenues for the first quarter increased to $118.4 million, up 105 percent from pro forma revenues of $57.6 million for the first quarter 2000, and up 11 percent from pro forma revenues of $106.4 million for the fourth quarter of 2000. The company's pro forma gross profit margin of 64.7 percent for the first quarter of 2000, and 71.7 percent, on a pro forma basis, for the fourth quarter of 2000. Pro forma net income for the first quarter was $4.0 million, or $0.04 per share. That compares to pro forma net loss of $33.7 million, or $0.35 per share, for the first quarter of 2000 and pro forma net loss of $14.6 million, or $0.14 per share, for the fourth quarter of 2000.

231. According to Giesecke, this press release misrepresented Homestore's strong and steady growth in the first quarter. Giesecke testified that Homestore did not have strong and steady growth that quarter "because it used the round-trip transactions to make up the difference between what it could actually produce in terms of legitimate revenue and what it ultimately reported here." Homestore's reported revenue of $118.4 million included about "$15 million of round-trip revenue associated with the AOL scheme." In the final analysis, Giesecke agreed

that "15 of 42.1 million, approximately a third of Homestore's overall advertising was illegitimate." Homestore did not want the public to know that "because the related revenue was fraudulent."

232. On April 26, 2001, Robertson Stephens analysts Jay P. Leupp and Paul R. Penney adjusted their estimates for 2001 and 2002 in light of Homestore's strong first quarter results. The 2001 estimates for revenue and earnings per share were adjusted upward from $442.9 million and $0.44 respectively to $502.6 million in revenue and $0.54 in earnings per share for 2001. The 2002 estimates for revenue and earnings per share were adjusted from $611.8 million and $0.84 to $665.0 million in revenue for 2002 and $0.90 earnings share. The report reiterated Robertson Stephens "Buy" rating for Homestore stock.

233. On April 26, 2001, Salomon analysts Albright and Bruce van Raalte touted Homestore's "terrific" first quarter revenues. The report noted the $75.6 million in subscription revenue, which was up 18% over the fourth quarter of 2000. In a section of the report entitled "Strong Story, Great Visibility," Salomon raised its revenue estimates and earnings per share estimates for 2001 and 2002. Revenues for 2001 were raised from $443 million to $515 million for 2001 and from $600 million to $680 million for 2002. Earnings per share estimates were also raised for 2001, from $0.44 to $0.53 and in 2002 from $0.84 to $0.90. The report strongly endorsed Homestore's promising future again, stating that "Homestore represents the original vision of an Internet company fulfilled." Salomon gave the stock an "Outperform, High Risk" rating and described Homestore as a "terrific franchise."

234. On April 26, 2001, Merrill Lynch analysts Blodget and Campbell, in a report entitled "Another Strong Quarter; Raising Estimates Again," raised 2001 estimates "from $450mm to $502mm" and raised earnings per share estimates "from $0.85 to $0.95." The report boasted: "This is the third estimate increase in three months–impressive, considering the environment." This increase was "based

on higher sales, improved operating margin and slightly lower interest income." Blodget and Campbell indicated that advertising revenue was surprisingly ahead of their forecast: "Ad revenues were down 2% seq. at $42.6mm but ahead of our est. of $41.7mm, an impressive feat in a market we believe declined 25% during the quarter."

235. The market reacted positively to these analyst reports, with Homestore's stock moving from $28.73 at the closing of April 25 to $34 at the closing of April 26, or an 18% increase.

236. On May 1, 2001, ABN AMRO analysts Arthur Newman and David J. Kolb, in an article entitled "Home Is Where the Profits Are: [Homestore stock] Exceeds Estimates," reported that Homestore's first quarter financials "were well ahead of our and consensus estimates." In addition, ABN AMRO analysts noted "the strength [of Homestore's] business model, even in tough economic times, and impressively slashed costs from its recent acquisition of Move.com." Homestore's "revenue mix" was described as a healthy combination of subscriptions and advertising revenue:

> About 65% of estimated 2001 revenue comes from selling subscription services, such as Websites linked to real estate listings and integrated contract-management software, to real estate firms and professionals. Online advertising represents most of the remaining revenue, although transaction revenue should eventually become a material part of the business model.

Advertising revenue for the company was reported as surprisingly consistent, in contrast to other major Internet stocks' advertising revenue which had declined during the same period:

> Advertising revenue was $42.6 million, representing 36% of 1Q01 revenue, vs. 41% in 4Q00, and 36% in 1Q00, which we consider quite an accomplishment, given the generally poor state of online advertising. By comparison, Yahoo! reported a 50% decrease in domestic online advertising revenue over the same period. We believe [Homestore stock] is successful because it can deliver a highly targeted audience poised to make significant financial outlays,

> financially stable nondot-coms. The company estimates that less than 6% of its advertising revenue (or less than 2% of total revenue) is derived from dot-coms.

ABN AMRO analysts' conclusions about Homestore were particularly enthusiastic:

> Homestore.com reported exceptionally strong 1Q01, reporting figures that were well above expectations. We believe this would be a strong performance in any quarter, but it is particularly notable given the widespread poor performance among e-commerce companies and other dot-coms. On April 26, we raised our 2001 [sic] and 2001 forecasts for revenue and profits, lately a rare event in the Internet or technology sector.
>
> In our view, [Homestore's stock] is not a typical Internet company. In our analysis, it dominates the market for online media and software for the real estate industry, has deep industry partnerships, has a healthy revenue mix with a strong recurring component, has broad online distribution with improving online metrics, is profitable, and has no material competitors. We believe the 1Q01 performance confirms the validity of the company's business model. With its attractive valuation, [Homestore stock] remains the only Buy-rated stock in our consumer Internet universe.

237. The market reacted positively to the report, with Homestore's stock moving from $31.95 at the closing of April 30 to $33.20 at the closing of May 1, or a 4% increase. The market's positive reaction continued the next day, with Homestore's stock price moving up to $35.90 at the closing of May 2, another 8% increase.

238. On May 10, 2001, in response to "questions about Homestore's liberal use of equity to pay for operating expenses, as well as the validity of excluding these expenses from pro forma EPS," Merrill Lynch analysts Blodget, McCabe and Gernitis revised Merrill Lynch's financial estimates in light of Homestore's use of equity, mainly Homestore stock, to pay for various operating expenses while excluding those payments from the company's valuation calculations. The report indicated that unlike comparable Internet and technology companies, such as Yahoo!, eBay or AOL, Homestore's reported pro forma results "exclude some non-cash, stock based expenses that we regard as operating expenses." Therefore, Merrill Lynch opined that "the *pro forma* results are meaningful as a measure of

current cash earnings, but not operating earnings. [Other Internet stocks'] pro forma results, in contrast, are closer to true operating earnings." However, Homestore's pro forma results were cited as providing "a good view of the company's cash consumption/generation" and therefore were useful in forecasting Homestore's cash flow. Homestore's pro forma earnings per share were much higher than other Internet and technology companies. Merrill Lynch analysts attributed this difference as follows:

> Homestore pays for many of its content, distribution, and marketing expenses using stock instead of cash (which is a legitimate, defendable, and even shrewd decision for a young company with a strong currency, in that it conserves cash). . . The equity cost to Homestore of the AOL deal and other deals is included in the "stock-based charges" line on the income statement. This line is excluded from pro forma results (under the theory that it is a non-cash expense).

239. Merrill Lynch continued to report about the company's "upside" and stated that:

> Homestore has consistently beaten estimates in the past. Over the last four quarters, the company has bested our quarterly revenue estimates by as much as 25% and no less than 7%. Similarly, our EPS estimates have been beaten by as much as $0.06 and no less than $0.02. Although we're at the high-end of the street for 2001 and 2002 (as we have generally been in the past), we still believe upside is likely. To avoid assessing valuation on EPS estimates that are too low, therefore, we believe investors should assume some upside to the company's stated targets (and consensus estimates).

240. On May 15, 2001, Homestore filed its Form 10-Q, reporting quarterly financial results for Q1 2001. Homestore represented in its 10-Q that the company's financial results were presented in accordance with GAAP. However, as alleged below, the statements in both the April 25, 2001 press release and the Form 10-Q were materially false and misleading because Homestore overstated its on-line advertising revenue. Certain advertising transactions should not have resulted in revenue recognition because they were barter transactions, the buying of revenue or "round-tripping."

241. Homestore's misrepresentation that its financial results were presented in accordance with GAAP misled readers into believing that they could rely on how the company's financial condition was presented. Independent of that deceptive conduct, because Homestore knowingly and improperly recognized revenue from barter transactions, the buying of revenue, or round-trip transactions, Homestore's filing of its May 15, 2001 10-Q misrepresented the company's revenues.

242. On May 16, 2001, Robertson Stephens analysts Leupp and Penney, in an article entitled "Urge Investors to Take Advantage of Current Price Weakness, as We Believe the Company's Dominant Position in the Real Estate Media & Technology Sector Will Overshadow Near-Term Valuation Debate; Reiterate Buy Rating," defended Homestore in light of the report written by Merrill Lynch analysts questioning Homestore's frequent use of stocks instead of cash to pay for operating expenses. The report stated that paying operating expenses with stock was disclosed fully and was "more than justifiable, given [Homestore]'s industry dominance and adequate cash reserves." Robertson Stephens analysts cited Homestore's business growth (acquisitions), growth in professional services (new subscriptions), and growing site usage as factors validating "the functionality of Homestore.com's network of sites." Homestore stock was rated "Buy" and the report forecast that "the company's recent acquisitions and partnerships . . . further enhance [Homestore]'s dominance as the real estate platform of choice for both real estate consumers and professionals." The market reacted positively to the report, with Homestore's stock moving from $29.44 at the closing of May 15 to $30.50 at the closing of May 16, or a 4% increase. The positive reaction continued the next day, with Homestore's stock moving to $33 at the closing of May 17, or another 10% increase.

243. On June 26, 2001, Merrill Lynch analysts Blodget and Campbell raised estimates for Homestore's revenue once again, and the report indicated that there was "little that would change the company's habit of delivering modest upside to its targets, and our model suggests there is upside to these targets. We are therefore raising our estimates." The report forecasted that "[r]evenue increase [would be] driven by higher professional subscription revenue . . . as Homestore recognizes a full period of revenue from Cendant related subs." Blodget and Campbell concluded:

> In the current environment, making our projection of flat sequential advertising revenue for Q2-Q4 will not be a lay up, but, in our view, it is achievable for three reasons: 1) the AOL deal has nearly doubled inventory, 2) the audience is highly targeted and with the Move.com acquisition, Homestore is the only game in the real-estate town, and 3) total dotcom exposure is low–under 6% of advertising revenue.

244. In another report dated June 26, 2001, Merrill Lynch analysts Blodget and Campbell reported that, with regard to fiscal year 2001 revenue, they expected Homestore's revenue to increase to $525 million and pro forma earnings per share to be $0.56. These numbers were considerably higher than the industry consensus of "$500mm/$0.53", and Merrill Lynch maintained its "Buy" rating for the stock.

245. On July 25, 2001, Homestore issued a press release entitled, "Homestore.com, Inc. Reports Eighth Consecutive Quarter of Strong Results," claiming the Company had achieved "record" results and a third quarter of cash "profitability." Wolff boasted about the "continued strength in both major revenue streams: subscriptions and advertising." In pertinent part, Homestore stated:

> Homestore.com, Inc., the leading supplier of technology and online media to the home and real estate industry, today reported record revenue of $129.3 million and pro forma net income, excluding certain charges, of $14.5 million, or $0.13 per share, for the second quarter of 2001, the company's fourth consecutive quarter of increasing pro forma earning per share.
>
> "I am pleased to announce our eighth consecutive public quarter of strong top and bottom line results, particularly given the difficult market climate," said Stuart Wolff, Homestore's chairman and chief executive officer. "The strength of our quarter is testament to the

> speed with which we have integrated Move.com and the continued strength in both major revenue streams: subscriptions and advertising."
>
> The company said revenue for the second quarter reached a record $129.3 million, a 79 percent increase over pro forma revenue of $72.4 million for the second quarter of 2000. The company's gross profit margin was 74 percent for the second quarter compared to a pro forma gross profit margin of 71 percent for the second quarter of 2000. Pro forma net income for the second quarter was $14.5 million, or $0.29 per share for the second quarter of 2000.

246. According to Giesecke, this press release misrepresented Homestore's revenues in the second quarter. Giesecke testified that the press was not accurate "because it included a significant amount of revenue related to the round-trip transactions." Homestore's advertising revenue and total revenue were overstated. In the final analysis, Giesecke agreed that Homestore "didn't want investors to know that's [the round-trip transactions] where a significant amount of our revenue was coming from." Homestore did not want the public to know that "because it [the round-trip transaction] was fraudulent."

247. On July 26, 2001, Merrill Lynch analysts Blodget and Campbell reported that they would raise estimates in light of Homestore's reportedly strong second quarter revenue reports. Blodget and Campbell wrote that "Q2 Revs and EPS were in line with our estimates (and well above consensus)." The report stated that second quarter revenue "was $129mm (+79%), driven (ironically) by strong advertising revenue. EPS was $0.13, driven by aggressive cost cutting after the Move.com acquisition." Revenue estimates were increased "from $500mm to $530mm (+64% Y/Y) and pro forma EPS remains at $0.55. 2002E rev. goes from $650mm to $685mm (+29% Y/Y), and [pro forma] EPS from $1.00 to $1.10 (+100% Y/Y, above company target of $0.93)." In comparison, Homestore's revenues on a "fully-taxed, operating basis," were estimated at "about $0.35 in 2002 and $0.70 in 2003." The market reacted positively to the report, with

Homestore's stock moving from $25.70 at the closing of July 25 to $27.34 at the closing of July 26, or a 6% increase.

248. On August 14, 2001 Homestore filed Form 10-Q, which reported its 2Q 2001earnings. Homestore represented that the company's financial results were presented in accordance with GAAP. However, as alleged below, the statements in both the July 25, 2001 press release and the Form 10-Q were materially false and misleading because Homestore overstated its online advertising revenue. Certain advertising transactions should not have resulted in revenue recognition because they were barter transactions, the buying of revenue or "round-tripping." Homestore improperly recognized revenue from its round-trip transactions with AOL, which revenue was nothing more than a recycling of Homestore's cash. In addition, as detailed in the information for Defendant Mark Roah in *U.S.A. v. Bohan, Roah, and Bickerton* (CR 03-374) (C.D. Cal.), Homestore's round-trip deals with L90 during the second quarter allowed Homestore to recognize its own cash as revenue in violation of GAAP.

249. Homestore's misrepresentation that its financial results were presented in according with GAAP misled readers into believing that they could rely on how the company's financial condition was presented. Independent of that deceptive conduct, because Homestore knowingly and improperly recognized revenue from barter transactions, the buying of revenue, or round-trip transactions, Homestore's filing of its August 14, 2001 10-Q misrepresented the company's revenues.

250. In a report entitled "Home Alone: Beats Estimates," ABN AMRO analysts Arthur Newman, David J. Kolb and Suk Han announced that:

> Even in this challenging economic environment, [Homestore] continues to excel. We continue to see [Homestore stock] as a core and reasonably valued holding, and it remains the only Buy-rated stock in our universe.

ABN AMRO's report indicated that Homestore's second quarter reported earnings per share of $0.13 was "comfortably ahead" of their estimate of $0.11. In light of Homestore's reported earnings ABN AMRO raised their earnings per share estimates for 2001 to $0.55 from $0.51 and raised their revenue forecast to $523 and $680 for 2001 and 2002 respectively. The report noted Homestore's advertising revenue was $50.6 million or 39% of first quarter 2001 revenue, calling the reported growth in advertising revenue of 18.6% "quite an accomplishment, given the generally poor state of online advertising." The report compared Homestore's valuation at 46.7 times estimated 2001 earnings per share to eBay's current valuation of 128.4 times estimated 2001 earnings per share. Homestore's valuation was forecast to have "upside" for 2002 compared to ABN AMRO's estimates.

251. On August 6, 2001, Piper Jaffray analysts Safa Rashchy and Joshua S. Meyers reported that their brokerage house would initiate coverage of Homestore stock, giving the stock a target value of $45 or 75 times estimated, fully taxed 2002 earnings per share. The analysts noted several indicators of the strength of Homestore's business: (i) the "nearly 8 million monthly unique visitors (nearly twice its nearest competitor) and the large number of real estate professionals who are members of Homestore's network; (ii) the migration of real estate professionals onto the Internet; and (iii) Homestore's diverse revenue sources; solid revenue from non-dot-coms and solid revenue growth from advertising generally." Growth catalysts listed were: "1) continued migration of real estate functions online; 2) up-selling, cross-selling, and increasing prices of subscription services; and 3) continued strong advertising revenues." The report noted a 60/40 ratio of subscription revenue to advertising revenue. Rashtchy and Meyers concluded:

> HomeStore has a highly profitable and sustainable business model in a growing market. Although execution and expansion of this model are not without risks, especially given various partnerships and arrangement [sic] the Company maintains. We believe Homestore will

be able to sustain the expected growth rates in the next four to six quarters.

252. On August 13, 2001, Piper Jaffray analysts Rashtchy and Meyers touted Homestore's acquisition of iPlace.com as representing a possible third source of revenue, consumer subscriptions, to Homestore's existing revenue sources. The report stated that although the price of the acquisition could be described as "a little rich," Piper Jaffray "remain[ed] positive on the growth outlook of Homestore and maintain[ed their] "Buy rating."

253. On August 14, 2001, Homestore's Wolff announced "[c]onsumer home and real estate traffic continues to be a key driver of our revenue streams and we are extremely pleased that the Homestore Network of Websites is now drawing nearly double the amount of individuals it did at this time last year." The market reacted positively to the news, with Homestore's stock moving from $21.61 at the closing of August 13 to $22.81 at the closing of August 14, or a 5% increase.

254. On August 24, 2001, Salomon analysts Lanny Baker, Eileen Furukawa and Karin Brett, in an article entitled "HOMS: Survey Says Foundation Laid, Homestore Hammering Away," announced the results of a telephone survey of "176 real estate professionals employed by Cendant franchises." This survey seems to have been performed "partially out of concern about [Homestore's chances of] renewing 180,000 subscriptions originated in a bulk purchase by Cendant." Salomon's survey found that there was "enthusiasm about the internet" among those contacted in the survey. The survey also found that people familiar with Homestore's product often used the site's services. However, surprisingly, "half of the iLEAD subscribers were unaware of the service that Cendant has subsidized on their behalf." Of those contacted, the survey found that many of the Cendant subscribers would likely not renew their subscriptions with Homestore. The report identified "moving beyond the overhang of the Cendant-user renewal process and weathering a softening online advertising market" as hurdles to

Homestore's continued growth. Salomon's analysts believed that Homestore could overcome these hurdles:

> Homestore currently enjoys a healthy valuation based on EBITDA and pro forma earnings estimates, which estimates in themselves have been aided by the strong use by Homestore of equity in lieu of cash payments. All that being said, we strongly believe in the company's long-term prospects given the huge market opportunity ripe for the taking by Homestore.

The market reacted positively to the report, with Homestore's stock moving from $20.50 at the closing of August 23 to $21.58 at the closing of August 24, or a 5% increase.

255. On August 28, 2001, Homestore's share value sank by more than 12% and hit a 52-week low. Wolff told Bloomberg News that nothing had changed to cause this drop. Wolff stated, "All we've had is positive news, eight positive quarters."

256. On September 6, 2001, Homestore announced in a press release that it was "reaffirming revenue guidance of $134 million for the third quarter or 2001." The press release indicated that Homestore would maintain its pro forma earnings per share "guidance, excluding certain items, of $0.16."

257. Later on September 6, 2001, Homestore issued a second press release, stating that it was "on target to meet or beat I-LEAD XL 2002 renewal targets" for the sales associates affiliated with Cendant's [real estate brokers]."

258. According to *The New York Times*, Homestore was also hyping its stock at trade conferences. "As recently as September 6, for example, Homestore executives took their show to investors at Salomon Smith Barney's 2001 Technology Conference in New York. They confirmed analysts' projections for a big earning pop in the third quarter and the full year, and, using a figure from a previous quarter, said the company held more than $325 million in cash. But this figure included $90 million that cannot be touched under the terms of a deal with AOL and $70 million earmarked for acquisition."

259. In preparation for its September 10, 2001 article entitled, "Accounting Issues Dog Homestore.com," the *Los Angeles Business Journal* attempted to obtain the facts about how Homestore was calculating its reported earnings, noting: "Depending on how you're counting, the second quarter results either generated a net income of $14.5 million, about 13 cents a share - or a net loss of $72 million, about 31 cents a share." The $72 million figure was derived using GAAP accounting principals, while the $14.5 million figure was calculated using pro forma earnings. The *Los Angeles Business Journal* reported: "Wolff would not address pro-forma numbers during the brief interview. Several hours later Gary Gerdeman, a spokesperson for the company, e-mailed a note to the *Business Journal* that said: 'I'm sorry to report that I can't make anyone else available for an interview on this matter, but I do appreciate your interest in Homestore.'" On August 19, 2001, Wolff told the *Los Angeles Times* that pro forma earnings are simply another tool investors can use to measure performance, and not a way to inflate results: "We don't tell investors what's important and what's not."

260. Other Homestore executives made similar comments about Homestore's pro forma policy. On August 9, 2001 the *Ventura County Star* reported that, "Joseph Shew, Senior Vice President and Chief Financial Officer of Homestore, declined to take sides on the valuation debate but defended his company's use of pro forma earnings." On June 4, 2001, Giesecke told the *Industry Standard* that, "most technology companies report pro-forma results. These were not just stock-for-revenues deals. We are creating partnerships here."

261. Analysts appeared to accept these repeated assurances. On September 10, 2001, the *Los Angeles Business Journal* reported that, "Henry Blodget of Merrill Lynch said that while using equity to pay for operating expenses like marketing is certainly appropriate, reporting as pro forma expenses makes it difficult to analyze the company's value. 'This is not a disclosure issue. It is, however, a valuation issue.'"

262. Following the events of September 11, 2001, Homestore's spokesperson, Gary Gerdemann, shifted blame for Homestore's revenue shortfall to the events of that tragic day. "Once September 11 happened, we were completely unable to make sales calls or close any pending." Only five days prior to September 11, the company was still hyping their stock at the Salomon Smith Barney's 2001 Technology Conference in New York.

263. On October 3, 2001, Homestore announced that it would not meet its third quarter expectations because of the September 11, 2001 attacks. According to Giesecke, Wolff reviewed the press release before it went out. Thus, Wolff knew that the press release misrepresented the reason for Homestore's poor third quarter performance – and for its purported stellar performance in the first and second quarters of 2001.

264. Homestore did not meet its third quarter revenue target. On November 1, 2001, Wolff again publicly blamed the September 11, 2001 attacks for Homestore's poor performance during the third quarter. DeSimone, Giesecke and Tafeen all testified in *Wolff* that September 11 had nothing to do with Homestore missing its target in the third quarter of 2001.

265. Tafeen testified that not a single contract failed to close after September 11 that was scheduled to close prior to that date. Nor was it true that Homestore missed its target because GMAC, Dorado and Wells Fargo failed to renew contracts. According to Tafeen, the impact of those deals was known before the third quarter began.

266. On October 3, 2001, Homestore shocked the market when it issued a press release stating that it was reducing its projected revenue and earnings for the third quarter of 2001. Homestore projected that its third quarter revenue would only be between $118 and $144 million, which would result in a pro forma loss per share of between $0.01 and $0.06 per share. The market reacted negatively to the news, with Homestore's stock moving from $7.05 at the closing of October 2 to

$6.20 at the closing of October 3, or a 12% decrease. Homestore's stock price continued to fall the next day, closing at $5.68 for another 8% decrease.

267. On November 1, 2001, Homestore issued another press release entitled "Homestore Reports Third Quarter Results," predicting even lower revenues than previously announced:

> Homestore.com, Inc., the leading supplier of technology and online media to the home and real estate industry, today reported revenue of $11.61 million and a pro forma net loss, excluding certain charges, of $6.9 million or $0.06 per share for the third quarter 2001.
>
> "In light of the changed business environment, we are taking the actions necessary to maintain our leadership position in the online real estate market," said Stuart Wolff, Homestore chairman and chief executive officer.

268. As expected, the market reacted negatively to the news, with Homestore's stock price plummeting from $4.99 at the closing of November 1 to $2.28 at the closing of November 2, or a 54% increase.

269. On November 14, 2001, Homestore filed its previously reported quarterly financial results for Q3 2001. Homestore represented that the company's financial results were presented in accordance with GAAP. However, the statements in both the November 1, 2001 press release and the Form 10-Q were materially false and misleading because Homestore overstated its online advertising revenue. Certain advertising transactions should have been itemized as barter transactions rather than revenue because they were related to purchases of goods and services from third parties.

270. For example, according to the Information for L90 executive Mark Roah in *U.S.A. v. Bohan, Roah, and Bickerton*, Homestore engaged in fraudulent round-trip transactions during the third quarter involving Homestore and L90, whereby Homestore agreed to purchase advertising on other websites and, in return, L90 agreed to purchase advertising from Homestore. From these transactions, "Homestore fraudulently recognized the $5,650,000 advertising fee from L90 as revenue in the third quarter 2001." Homestore also improperly

recognized revenue from its round-trip transactions with AOL and Cendant, which revenue was nothing more than a recycling of Homestore's cash. Roah testified in the Wolff criminal trial that he helped set up the L90 transactions.

271. Homestore's misrepresentation that its financial results were presented in accordance with GAAP misled readers into believing that they could rely on how the company's financial condition was presented. Independent of that deceptive conduct, because Homestore knowingly and improperly recognized revenue from barter transactions, Homestore's actions misrepresented the company's revenues. Further, as explained herein, because Homestore knew that the existence of the Preferred Alliance Agreements was a reportable condition when the company filed its 10-Q on November 14, 2001, Homestore's deliberate failure to discuss the Preferred Alliance Agreements in the 10-Q independently misrepresented Homestore's revenues. Thus, Homestore's November 14, 2001 10-Q filing misrepresented Homestore's revenues.

272. Tafeen testified in *Wolff* that "these [round-trip] deals were – were bogus; so it meant that the 10-Q [for the first, second and third quarters of 2001] was bogus." Thus, the Homestore 10-Q statements filed on May 15, 2001, August 14, 2001, and November 14, 2001 misrepresented Homestore's financial performance in furtherance of a scheme to defraud investors, and occurred because of the bogus round-trip transactions.

273. The efficient market theory does not hold that every piece of information is incorporated in a stock's price the same way in every single instance. As Eugene Fama, the founder of the efficient market hypothesis, explains in an 1998 article:

> Consistent with the market efficiency hypothesis that the anamolies are chance, apparent overreaction to information is about as common as underreaction, and post-event continuation of pre-event abnormal returns is about as frequent as post-event reversal.

Therefore, negative movements in stock price to purportedly positive information (*e.g.,* an analyst's "buy" recommendation) are within the purview of the efficient market theory. Such movements do not disprove the existence of an efficient market for Homestore stock because the efficient market theory specifically acknowledges that anomalous price movements may occur. The efficient market hypothesis makes the central argument that these anomalies are random and do not open the door to abnormal profits through trading strategies.

274. The effect of downward movement in the stock price of comparable companies was stronger than the positive effect of the analyst reports. However, this explanation does not prove the absence of an efficient market for Homestore common stock. Instead, the sensible explanation is that the market incorporated both the industry trend and the analyst reports, but that effect of the downward industry was greater than the positive effect of the analyst reports. This explanation is consistent with the anomolies in price movements, such as underreactions and overreactions to news, that Fama observed.

275. Some analyst reports disseminated information already known to the markets (*e.g.*, revenue numbers). To that extent, the analyst reports did not introduce new information into the market, but rather interpreted existing information about Homestore. The October 20, 2000 Merrill Lynch report, which maintained a "Buy" rating for Homestore stock, was based on an October 19 Homestore press release concerning its third quarter results. Thus, consistent with the efficient market hypothesis, the reports, even if positive, would not be expected to cause upward movements in Homestore's stock price.

E. <u>THE TRUTH IS REVEALED AND IMPACT ON HOMESTORE'S STOCK PRICE</u>

276. On November 11, 2001, *The New York Times* reported that, "Since its public debut two years ago, [Homestore] had never been willing to provide a breakdown of its ad revenues for anyone interested in seeing what portion came

from sponsorships and how much came from spot ads." Mark Rowen, an analyst from Prudential Securities, stated that, "Homestore was particularly difficult to figure out. Even if you thought something wasn't right, it was hard to put your finger on it because of the lack of disclosure. But it seems almost unfathomable that management of an online advertising business would not know that it was going to miss projections by 40 or 50 percent until the last week of the quarter."

277. On December 6, 2001, Homestore announced that its Chief Financial Officer, Shew, had resigned "for personal reasons." In response to news of this resignation, Homestore's stock price fell another 20%.

278. On December 6, 2001, Merrill Lynch analysts Blodget, McCabe and Gernitis reported that the resignation of Shew "could create some uncertainty, which will likely be viewed as a negative." As a result of this news Merrill Lynch announced that it was placing Homestore's stock under review.

279. Two weeks later, Homestore begrudgingly began to reveal that its accounting, and the company's prior financial results, were inaccurate. In its December 21, 2001 press release entitled, "Homestore Announces Accounting Inquiry," Homestore stated in pertinent part:

> Homestore.com, Inc. announced today that the Audit Committee of its Board of Directors is conducting an inquiry of certain of the company's accounting practices. The Audit Committee has retained independent counsel and independent accountants to assist in connection with the inquiry. While it is not yet possible to predict the results of the inquiry, based on the inquiry to date, **the company has determined that it will restate certain of its financial statements.** The extent of the restatement and the periods it will cover has not yet been determined. (Emphasis added).

The press release mentions Homestore's acquisition of Cendant's Move.com and the potential need to take a charge from the acquisition.

280. In response, the NASDAQ stock market revoked Homestore's trading status on Friday, December 21, 2001. As of that date, Homestore's price per share was $3.60, down from a high during the Class Period of $122.25 on January 25,

2000. On December 24, 2001, NASDAQ announced that the halt on Homestore trading would continue until NASDAQ obtained "additional information [it had] requested" from Homestore.

281. Homestore's disclosure that it had to restate its financial statements satisfies the pleading requirements for loss causation because Cendant's misrepresentations regarding Homestore's sources of revenue are one reason Homestore had to issue its December 21 press release. A plaintiff is not required to show that the disclosure of a misrepresentation is the sole reason for the investment's decline in order to establish loss causation. Rather, the disclosure need only be one substantial cause of the investment's decline, and that is the case here.

282. On December 26, 2001, Piper Jaffray analysts Rashtchy and Meyers reported that "while the reemerged company may be a good acquisition target, we will continue to avoid the stock until the full inquiry is out." Piper Jaffray maintained their "Outperform" rating of the stock.

283. On January 2, 2002, Homestore issued a press release providing further information regarding its December 21, 2001 restatement. The press release entitled "Homestore Provides Additional Accounting Inquiry Information," stated in pertinent part:

> Homestore.com, Inc. (Nasdaq: HOMS) today released additional information about the inquiry by the Audit Committee of its Board of Directors into certain of the company's accounting practices, that the company announced in its press release on December 21, 2001. The Audit Committee, with the assistance of independent legal counsel and independent accountants, has continued to conduct a thorough inquiry into the company's accounting practices. The inquiry is not yet complete and, while it is not yet possible to predict the ultimate results of the inquiry, the company has made a preliminary determination that it will restate certain of its financial statements.
>
> **Based on the preliminary results of the inquiry to date, the company has determined that it overstated its on-line advertising revenues in the first three quarters of 2001 by between $54 million and $95 million in connection with certain advertising transactions that should have been accounted for as barter transactions because they were related to purchases by the**

> **company of goods and service from third parties.** When the company completes its analysis of the overstatements, the company intends to amend its previously filed reports on Form 10-Q for the quarter ended March 31, June 30 and September 30, 2001 to reflect these and any other required adjustments to its financial statements for those periods. Accordingly, investors should not rely upon the company's previously filed reports on Form 10-Q for those quarters or the financial statements contained therein.
>
> Because the inquiry by the Audit Committee is not complete and the Audit Committee is examining a large number of transactions, there may be additional material restatements of the company's financial results once the inquiry is complete. The transactions under review include transactions that occurred in the year 2001, as well as transactions that occurred in the year 2000. The company cannot at this time quantify the amounts of potential additional restatements. Any additional restatements, if required, could have further material adverse impact on the company's reported financial results. Such restatements could also include a restatement of financial results for the year ended December 31, 2000. The Audit Committee and the company are firmly committed to completing a thorough, expeditious inquiry of these matters in an independent, objective manner, and currently expect to complete the inquiry by the end of the first quarter of 2002. (Emphasis added).

284. Other commentators expressed concern that Homestore waited so long to admit that it would have to restate its revenue. On December 28, 2001, Bambi Francisco, a market commentator for CBS.MarketWatch.com, questioned "why [Homestore] chose to disclose the information on Friday, right before the weekend holiday." Francisco stated that a Homestore spokesperson, "would not comment on when [Homestore] decided to arrange the inquiry or when its board hired independent attorneys and accountants." Francisco queried whether Shew, who left Homestore after only being with the Company for ten months, was "aware of the potential restatements." Francisco suggested that the decline in advertising sales "ignit[ed] concerns that [Homestore] was playing loosey-goosey with its books."

285. On December 27, 2001, James J. Cramer of TheStreet.com questioned the choices made by Homestore regarding disclosure:

> Earlier this year, I praised Homestore.com. I didn't know at the time that it was doing things wrong with its accounting. This was in August, when I still felt it was being forthright. By October I

> recognized that things were wrong at Homestore and I communicated that, but I admit to being fooled by the folks at Homestore and I regret it. I point this out because I hate making such mistakes, mistakes that might have cost you money, and I apologize for it. The problem is, as always, you can't game accounting shenanigans. You can't game when people don't tell you the truth. I think people have to realize that when managements [sic] don't play it kosher, its very easy to be fooled. All of us are susceptible to being fooled because we start with the preconception that managements [sic] are honest. Had Homestore been honest, I would never have written about it positively.

286. Homestore's announcements shocked the markets. George Nichols, a Morningstar analyst wrote on January 3, 2001:

> The magnitude of this overstatement is quite staggering: Based on the company's current estimates, between 45% to 80% of total ad revenues for the past three reported quarters should not have been recorded as sales. Shareholders ought to bail out of the stock, although that's easier said than done considering the NASDAQ has halted trading in the shares since December 24.

287. A reported $118 million in advertising revenue for the first three quarters of 2001 had essentially evaporated. Upwards of 80% of such "revenue" was, in fact, from barter transactions which should have been excluded from, or separately accounted for, in Homestore's financial statements, in accordance with ETIF No. 99-17. Reported earnings were also materially inflated for each of the periods. As *The New York Times* reported on January 27, 2002, the barter transactions were not simple ad swaps, but exchanges for goods and services. Brett Trueman, an accounting professor at the Haas School Business at the University of California at Berkeley, stated that Homestore vastly overstated the value of these transactions.

288. On January 7, 2002, three important events occurred. First, Homestore announced that Wolff was resigning and that it had appointed a new Chairman, Chief Executive Officer, Chief Operating Officer, and Chief Financial Officer. Second, Homestore issued a press release entitled, "Homestore Provides Additional Information to NASDAQ." Third, NASDAQ restarted trading in

Homestore common stock. Homestore's common stock price fell 32% that day with a closing price of $2.46.

289. On January 16, 2002, Homestore issued a press release announcing that it had taken disciplinary action against several employees based on the inquiry conducted by its Audit Committee. Homestore terminated or accepted resignations from seven employees, three of whom had already been put on administrative leave. Homestore stated that it was prepared to take additional future disciplinary action if the need arose. In pertinent part, Homestore stated:

> Before today, the company had placed three employees on administrative leave in connection with the audit committee inquiry and the company may take additional disciplinary measures because of the inquiry. The employees placed on leave were members of the finance department and business development department.

290. In September and October of 2002, DeSimone, Geisecke, and Shew pled guilty in the United States District Court for the Central District of California to knowingly falsifying Homestore's revenue records. In March 2003, Kalina pled guilty to violations of securities law. In March 2006, Tafeen pled guilty to security fraud violations. In total, 13 former Homestore employees have pled guilty and/or have settled charges with the SEC for their fraudulent conduct at Homestore.

F. <u>VIOLATIONS OF SEC RULES</u>

291. Defendants violated Item 303 of Regulation S-X under the federal securities laws, 17 C.F.R. § 229.303, when they failed to disclose the existence of these trends and uncertainties that they reasonably expected would have a materially favorable or unfavorable impact on net revenues or income or that were reasonably likely to result in Homestore's liquidity decreasing in a material way. Defendants' failure to disclose what they knew rendered their statements made during the Class Period materially false and misleading. For example, Defendants failed to report the voiding of the Preferred Alliance Agreements, even though doing so materially affected Homestore's revenues. Defendants violated Rule

4-08(K) of Regulation S-X, 17 C.F.R. § 210.4-08(K) when they failed to report related party transactions. These failures to disclose misrepresented Homestore's revenues in furtherance of a scheme to defraud investors.

G. VIOLATIONS OF ACCOUNTING RULES

292. GAAP are recognized and used by the accounting profession in order to define acceptable accounting practices at a particular time. The SEC has also endorsed GAAP in Regulation S-X, 17 C.F.R. § 210.4-01(a)(1), which provides that financial statements filed both annually and quarterly with the SEC must comply with GAAP. If the filings do not comply with GAAP, they are presumed to be misleading and inaccurate, despite footnotes or other disclosures. Therefore, Defendants' misleading statements and omissions, described above, violated GAAP and SEC Regulations.

293. Statements of Financial Accounting Standards ("FAS") are the highest authority in GAAP and are created by the Financial Accounting Standards Board. GAAP provides other authoritative pronouncements, including Accounting Principles Board Opinions ("APB") and Statements of Position ("SOP") of the American Institute of Certified Public Accountants ("AICPA").

294. The responsibility for preparing financial statements that conform to GAAP rests with corporate management, as set forth in Section 110.03 of the AICPA Professional Standards:

> The financial statements are management's responsibility. Management is responsible for *adopting accounting policies and for establishing and maintaining internal control,* that will, among other things, record, process, summarize, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements. The entity's transactions and the related assets, liabilities, and equity are within the direct knowledge and control of management . . . . Thus, the fair presentation of financial statements in conformity with [GAAP] is an implicit and integral part of management's responsibility.

295. Pursuant to these requirements, Homestore, with Wolff's approval, represented in its reports filed with the SEC that its financial results were presented

appropriately in accordance with GAAP. Nevertheless, Homestore and Wolff knowingly disregarded the following fundamental GAAP principles when preparing the company's financial statements:

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

(b) Financial reporting should provide information that is useful to present and potential investors, creditors and other users in making rational, investment, credit and similar decisions (FASB Statement of Concepts No. 1, ¶ 34);

(c) Financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and matters that change such resources (FASB Statement of Concepts No. 1, ¶ 40);

(d) Financial reporting should provide information about how management of an enterprise has discharged it stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it (FASB Statement of Concepts No. 1, ¶ 50);

(e) Financial reporting should provide information about an enterprise's financial performance during a time period. (FASB Statement of Concepts No. 1, ¶ 42). This information is often used by investors and creditors in order to evaluate whether they are interested in future investment and credit offerings;

(f) Financial reporting should be reliable and relevant in that it represents what it purports to represent (FASB Statement of Concepts No. 2 ¶¶ 58-59);

(g) Financial reporting should be complete, in other words, all information that may be necessary to assure that it validly represents underlying events and conditions must be provided (FASB Statement of Concepts No. 2, ¶ 79);

(h) Financial reports should be conservative. Preparers must adequately consider uncertainties and risks inherent in business situations and reflect those issues in the reports (FASB Statement of Concepts No. 2, ¶¶ 95, 97); and

(i) Revenue must be realizable (collectible) and earned prior to recognition (FASB Statement of Concepts No. 5, ¶ 83).

296. The misrepresentations regarding GAAP misrepresented Homestore's revenues in furtherance of a scheme to defraud investors.

297. Throughout the Class Period, all the material misrepresentations and omissions particularized in this Complaint were disseminated and/or approved by Homestore and Wolff and those actions were a direct cause of the damages sustained by the Plaintiff and the Class.

H. HOMESTORE'S RESTATEMENT OF FINANCIALS

298. The actions of Defendants, including making public statements that included material omissions and/or misrepresentations, that ultimately forced Homestore to restate its financials, misrepresented Homestore's financial condition in furtherance of a scheme to defraud investors. As a part of the scheme to defraud, Homestore dramatically and materially overstated its revenues and assets for fiscal year 2000 through the third quarter of 2001, in violation of GAAP and SEC rules prohibiting "round-trip" or "barter" transactions.

299. Homestore's barter transactions did not meet the requirements of EITF No. 99-17 for recognition of revenue from advertising barter transactions. Moreover, Homestore's financial statements for the year ended December 31, 2000 were not prepared in accordance with GAAP. Homestore's advertising barter transactions were related to puchases of goods and services from other entities. Moreover, Homestore's restated financial statements for the year ended December 31, 2000 failed to present sufficient information on the advertising transactions to be in compliance with EITF No. 99-17.

300. Homestore's improperly recognized revenues accounted for 52.8% of Homestore's advertising revenue and 22.8% of total revenue for fiscal year end 2000. According to former senior executives of Homestore, it is not possible for an audit of the financial statements performed in accordance with GAAS to fail to discover these transactions given the pervasiveness of the conduct and the fact that it often occurred right at the end of a period in order to "make the numbers."

301. By restating its financial results, Homestore has admitted that its publicly-issued financial statements for each of the restated periods were not

prepared in conformity with GAAP, and that Homestore materially misstated its financial condition and results of operations. Under GAAP, the restatement of previously issued financial statements is reserved for circumstances where no lesser remedy is available. Under Accounting Principles Board Opinion No. 20, *Accounting Changes*, restatements are only permitted, and are required only to correct material accounting errors or irregularities that existed at the time the financial statements were originally prepared and issued.

302. Due to Defendants' and Homestore's improper conduct, Homestore was forced to restate its materially misleading financial statements, filed with the SEC in their Form 10-K for 2000 and the Form 10-Qs for the first, second, and third quarters of 2001. In Homestore's Form 10-K/A for the fiscal year ended December 31, 2000, filed March 12, 2002, Homestore made the following restatements and adjustments (*in thousands,* except per share amounts):

Quarter Ended March 31, 2000

	As Reported	Restated	Difference
Revenues......................................	$38,599	$37,622	$977
Gross Profit..................................	$27,841	$26,904	$937
Loss from Operations.......................	$33,607	$33,607	$0
Net Loss Applicable to Common Stockholders..............	$29,212	$29,212	$0
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders..............................	$0.39	$0.39	$0

Quarter Ended June 30, 2000

	As Reported	Restated	Difference
Revenues......................................	$50,152	$42,244	$7,908
Gross Profit..................................	$36,719	$28,811	$7,908
Loss from Operations.......................	$30,986	$35,558	$4,572
Net Loss Applicable to Common Stockholders..............	$24,712	$29,284	$4,572
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders..............................	$0.31	$0.37	$0.06

Quarter Ended September 30, 2000

	As Reported	Restated	Difference
Revenues.....................................	$62,203	$48,835	$13,368
Gross Profit.................................	$45,878	$32,998	$12,890
Loss from Operations.......................	$32,851	$40,439	$7,588
Net Loss Applicable to Common Stockholders...............	$27,058	$33,946	$6,888
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders...............................	$0.33	$0.41	$0.08

Quarter Ended December 31, 2000

	As Reported	Restated	Difference
Revenues.....................................	$79,013	$52,581	$26,432
Gross Profit.................................	$57,290	$31,387	$25,903
Loss from Operations.......................	$33,074	$52,498	$19,424
Net Loss Applicable to Common Stockholders...............	$34,187	$53,611	$19,424
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders...............................	$0.41	$0.65	$0.24

(Homestore Form 10-K/A for 2000, pp. 59-60).

303. For the year ended December 31, 2000, Homestore reduced its reported revenue by $48.6 million and increased its net loss from $115.2 million to 146.1 million. Homestore also increased its net loss per share from $1.44 to $1.83 (Homestore Form 10-K/A for 2000, p. 4).

304. Homestore was forced to make similar restatements and adjustments to its financial statements for the first, second, and third quarters of 2001 in its Form 10-Q/As, filed March 29, 2002 (*in thousands*, except per share amounts):

Quarter Ended March 31, 2001

	As Reported	Restated	Difference
Revenues.....................................	$105,491	$61,341	$44,150
Gross Profit.................................	$77,463	$36,013	$41,450
Loss from Operations.......................	$58,803	$91,465	$32,662
Net Loss Applicable to Common Stockholders...............	$67,148	$99,810	$32,662
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders...............................	$0.71	$1.05	$0.34

(Homestore Form 10-1Q/A for 2001, p.7).

Quarter Ended June 30, 2001

	As Reported	Restated	Difference
Revenues.....................................	$129,283	$69,067	$60,216
Gross Profit.................................	$95,265	$44,349	$50,916
Loss from Operations.......................	$72,491	$120,722	$48,231
Net Loss Applicable to Common Stockholders..............	$72,075	$120,868	$48,793
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders..............................	$0.67	$1.12	$0.45

(Homestore Form 10-2Q/A for 2001, p.8).

Quarter Ended September 30, 2001

	As Reported	Restated	Difference
Revenues.....................................	$116,135	$76,588	$39,547
Gross Profit.................................	$84,399	$54,586	$29,813
Loss from Operations.......................	$86,611	$118,272	$31,661
Net Loss Applicable to Common Stockholders..............	$106,604	$138,325	$31,721
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders..............................	$0.96	$1.25	$0.29

(Homestore Form 10-Q/A for 2001, p. 9). For the first three quarters of 2001, Homestore reduced its reported revenue by over $143.9 million and increased its net loss from $245.8 million to $359 million. Homestore also increased its net loss per share from $2.34 to $3.42 (Homestore Form 10-Q/As for 2001).

305. According to Plaintiff's confidential sources, an internal Homestore investigation concluded that, beginning in the second quarter of 2000, Homestore entered into transactions that resulted in the improper recognition of revenue. The investigation further concluded that the transactions allow Homestore to recognize its own cash as revenue. Therefore, Homestore entered into the transactions which artificially inflated its revenues.

I. NO SAFE HARBOR

306. Defendants are not protected by the statutory safe harbor for forward-looking statements because that protection does not extend to the allegedly false statements pled in this complaint. First, many of the specific statements pled herein were not identified as "forward-looking statements" when made. Second, to the extent there were any forward-looking statements, Defendants did not provide

meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the purportedly forward-looking statements pled herein. Defendants are liable for those false forward-looking statements because they knew, at the time each such statement was made, and/or authorized and/or approved by an executive officer and/or director of Homestore and/or Cendant, that those statements were false.

FIRST CLAIM FOR RELIEF
VIOLATIONS OF SECTION 10(b), 15 U.S.C. § 78j(b) AND SEC RULE 10b-5, 17 C.F.R. § 240.10b-5

307. Plaintiff hereby incorporates by reference all of the allegations set forth above, as though fully set forth hereinafter.

308. Defendants, individually and in concert, engaged in conduct prescribed by Section 10(b) of the Securities and Exchange Act (15 U.S.C. § 978j(b)), which section was implemented through the promulgation of SEC Rule 10b-5 (17 C.F.R. § 240.10b-5). Defendants individually and in concert: (i) employed devices, schemes, and artifices to defraud, which conduct is made unlawful by Rule 10b-5(a) (17 C.F.R. § 240.10b-5(a)); (ii) made untrue statements of material fact and/or omitted material facts necessary to make the statements not misleading, which conduct is proscribed by Rule 10b-5(b) (17 C.F.R. § 240.10b-5(b)); and/or (iii) engaged in acts, practices, and a course of business which operated as a fraud and deceit upon the purchasers of Homestore's publicly traded securities, which conduct is made unlawful by Rule 10b-5(c) (17 C.F.R. § 240.10b-5(c)), in an effort to maintain artificially high prices for its publicly traded securities in violation of Section 10(b) of the Securities Exchange Act. Defendants, singly and in concert, are liable as primary participants, throughout the Class Period, in the wrongful and illegal conduct charges herein, or as controlling persons as alleged below.

309. Defendants, individually and in concert, directly or indirectly, by the use, means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about the business, operations, finances, and prospects of Homestore, as specifically set forth above.

310. Defendants, individually and in concert, employed devices, schemes, and artifices to defraud, while in possession of material, adverse, non-public information, and engaged in acts, practices, and a course of conduct as alleged herein in an effort to assure investors of Homestore's value and performance and continued substantial growth. In furtherance of their scheme, Defendants made or participated in the making of untrue statements of material facts. Moreover, Defendants made misleading statements when they omitted material facts necessary in order to make their statements regarding Homestore and its business operations and finances truthful. Defendants engaged in transactions, practices and a course of business which operated as a fraud and deceit upon the purchasers of Homestore's publicly traded securities during the relevant time period. This was contrary to Defendants' duty of full disclosure based on their participation in making affirmative statements and reports to the investing public. Defendants had a duty to promptly disseminate truthful, material information to investors (SEC Regulation S-X, 17 C.F.R. §§ 210.01, et seq. and Regulation S-K 17 C.F.R. §§ 229.10, et seq.).

311. The liability of Defendants, individually and in concert, arises from the fact that each Defendant (i) employed devices, schemes and artifices to defraud, which conduct is made unlawful by Rule 10b-5(a) (17 C.F.R. § 240.10b-5(a)); (ii) made untrue statements of material facts or omitted to state materials facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, which conduct is proscribed under Rule 10b-5(b) (17 C.F.R. § 240.10b-5(b)); and/or (iii) engaged in acts, practices, and a

course of business that operated as a fraud or deceit, which conduct is made unlawful by Rule 10b-5(c) (17 C.F.R. § 240.10b-5(c)), upon the purchasers of Homestore common stock during the Class Period.

312. During the Class Period, Defendants, and each of them, issued public statements and reports including financial statements and press releases as described above, which were materially false and misleading, in violation of Section 10(b) of the Securities Exchange Act, which section was implemented through the promulgation of Rule 10b-5(a), (b) and (c), delineated above.

313. Defendants, and each of them, had actual knowledge of the misrepresentations and omissions of material facts set forth above, or acted with deliberately reckless disregard for the truth, in that Defendants, and each of them, failed to ascertain and to disclose such facts, even though such facts were available to them. Defendants' material misrepresentations and omissions were done knowingly or with deliberate recklessness to conceal the true adverse financial conditions at Homestore and artificially inflate the market price of Homestore's securities, including common stock.

314. While in possession of knowledge, unknown to the public and investors, regarding Homestore's false financial statements and improper accounting, Wolff engaged in insider trading transactions, wherein he took advantage of the inflation of stock prices he and others created. During the Class Period, Wolff sold 693,600 shares of Homestore stock for proceeds of $33,763,389.75.

315. As a result of the wrongful conduct of Defendants, and each of them, the market price of Homestore common stock was artificially inflated during the Class Period. Relying upon the integrity of the market, and in ignorance of the adverse facts concerning Homestore concealed and misrepresented by Defendants, and each of them, Plaintiff and the members of the Class purchased Homestore common stock and were damaged thereby.

SECOND CLAIM FOR RELIEF

VIOLATIONS OF SECTION 20(a), 15 U.S.C. § 78t(a)

316. Plaintiff hereby incorporates by reference all of the allegations set forth above as though fully set forth hereafter.

317. Defendants Wolff and/or Smith, because of their position of control and authority as a Homestore directors and/or officers, were able to, and did control, the contents of the various SEC filings, press releases and analysts' reports. They exercised control over Homestore within the meaning of § 20(a) of the Exchange Act. Had Plaintiff and other members of the Class and the marketplace known that material information had been omitted, and/or misstated, pursuant to Defendants' fraudulent scheme, Plaintiff and the other members of the Class would not have purchased or otherwise acquired shares of Homestore common stock during the Class Period, or if they had acquired such shares during the Class Period, they would not have done so at the artificially inflated price which they paid.

318. Wolff and/or Smith had the ability, opportunity, and authority to prevent the issuance of the materially false and misleading SEC filings, press releases and analysts' reports or to cause them to be corrected. As a result, they were responsible for the accuracy of the public reports and releases detailed above as "group published" information, and Wolff and/or Smith are therefore responsible and liable for the representations contained therein.

319. Wolff and/or Smith are culpable participants in the violations of Section 10(b) of the Securities Exchange Act, which section was implemented by the promulgation of SEC Rule 10b-5(a), (b) and (c) thereunder, based on each having participated in the wrongful conduct alleged herein.

320. As a result of the wrongful conduct of Wolff and/or Smith, the market price of Homestore common stock was artificially inflated during the Class Period. Relying upon the integrity of the market, and in ignorance of the adverse facts

concerning Homestore, concealed and misrepresented by Defendants, and each of them, Plaintiff and the members of the Class purchased Homestore common stock and were damaged thereby.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff, individually and on behalf of the Class, prays for the following relief:

1. Continuing Certification of a Plaintiff Class pursuant to Rule 23 of the Federal Rules of Civil Procedure;
2. General and compensatory damages according to proof;
3. Special damages according to proof;
4. Reasonable attorneys' fees;
5. Cost and expenses of the proceedings;
6. Prejudgment interest at the maximum legal rate; and
7. Such other and further relief as the Court deems proper.

Dated: June 19, 2008 **COTCHETT, PITRE & McCARTHY**

By: /s/ Nancy L. Fineman
NANCY L. FINEMAN
Counsel for Lead Plaintiff CalSTRS and the Class

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Beverly Hills, CA 90212
(310) 247-9247
Of Counsel

JURY TRIAL DEMAND

Plaintiff, pursuant to Federal Rule of Civil Procedure 38, individually and on behalf of all others similarly situated, demands a trial by jury of all issues which are subject to adjudication by a trier of fact.

Dated: June 19, 2008 **COTCHETT, PITRE & McCARTHY**

By: /s/ Nancy L. Fineman
NANCY L. FINEMAN

Counsel for Lead Plaintiff CalSTRS and the Class

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