

numbers was the very reason these defendants engineered, directed, and implemented the round-trip transactions.

5. Several of AOL's customers were public companies with securities registered with the Commission, including, at least one, Veritas Software Corporation, that used the transaction with AOL to artificially inflate its own financial results.

6. As a result of each of the defendants' actions detailed below, the Company reported artificially inflated online advertising revenue in periodic reports and registration statements filed with the Commission and other public statements from at least October 2000 through at least the end of 2003.

7. The Company has since restated its financial statements to account for the fraudulent transactions referenced in this Complaint and more than a dozen similarly structured transactions. First, on January 28, 2003, the Company restated its financial statements for 2000, 2001, and 2002 to reverse \$190 million in principally online advertising revenue. On May 4, 2005, the Company again restated its financial statements for the same period to reverse an additional \$489 million in advertising revenue, including revenue recognized from transactions with Bertelsmann, A.G. On August 17, 2006, the Company announced its third restatement of its financial statements, this time for 2000 through the period ended June 30, 2006, reversing \$584 million of additional advertising revenue.

8. By engaging in the conduct alleged in this Complaint, Kelly, Rindner, Ripp, and Wovsaniker violated Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77q(a)]; Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78j(b)] and Exchange Act Rules 10b-5 [17 C.F.R. §§ 240.10b-5]; and

during the relevant period. Wovsaniker remains employed by the Company as a “special advisor,” although he was removed from his accounting responsibilities as a result of his involvement with the restated transactions.

RELEVANT ENTITIES

18. **Time Warner Inc.**, headquartered in New York, New York, is the successor corporation of **AOL Time Warner Inc.**, which was formed by the merger of **America Online, Inc.** and Time Warner Inc. on January 11, 2001. AOL Time Warner changed its name to Time Warner Inc. on October 16, 2003. During the relevant time period, AOL Time Warner filed annual, quarterly, and current reports with the Commission on Forms 10-K, 10-Q, and 8-K, registered securities offerings with the Commission, and traded its stock on the New York Stock Exchange. **AOL**, now a division of Time Warner, is an Internet service provider headquartered in New York, New York. Before it became a wholly-owned subsidiary of AOL Time Warner, AOL’s common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange. It filed annual, quarterly, and current reports with the Commission on Forms 10-K, 10-Q, and 8-K and registered securities offerings with the Commission. The pre-merger AOL and post-merger AOL Time Warner and Time Warner are collectively referred to as the “Company” or “AOL.”

19. **Ernst & Young LLP (“E&Y”)** is one of the “Big Four” accounting firms, headquartered in New York, New York. During the relevant time period, E&Y served as the Company’s external auditor, responsible for auditing the Company’s financial statements.

25. Each of the defendants, as described below, responded by knowingly or recklessly engineering a fraudulent scheme to enable AOL to recognize purported online advertising revenues by structuring, approving, implementing, and/or accounting for “round-trip” transactions – transactions in which AOL effectively funded its own advertising revenue by giving its counterparties the means to purchase AOL online advertising that the counterparties did not need or want. Defendants improperly and deceptively used this fraudulent online advertising revenue to inflate and distort the Company’s reported financial results and falsely make it appear as if AOL had legitimately made or exceeded its revenue targets and, later, to minimize any quarterly revenue shortfall.

26. Each of the defendants, as described below, committed manipulative and/or deceptive acts in furtherance of the aforementioned scheme and were responsible for the resulting fraudulent inflation of reported AOL online advertising revenue and other key reported financial results.

27. Rindner and other Business Affairs senior executives played a leading role in negotiating, structuring, documenting, and implementing certain of the round-trip transactions discussed below, which came to be known as “BA Specials.”

28. As described below, Kelly, Rindner, Ripp, and Wovsaniker knowingly or recklessly manipulated legitimate business transactions in order to artificially manufacture online advertising revenue and/or approved revenue recognition for the improper transactions.

29. Wovsaniker, the head of AOL’s Accounting Policy, made decisions on the accounting treatment to be accorded the round-trip transactions, provided advice on how

to structure and document the transactions and, on occasion, with others, took part in negotiations to make sure a deal was structured to achieve the desired accounting result – recognition of online advertising revenue regardless of the true nature of the deal.

30. Wovsaniker also directed that the contingent pieces of round-trip transactions be documented as separate, independent transactions, without any cross-referencing, thereby concealing the economic reality of those transactions from auditors.

31. Wovsaniker substantially contributed to various public statements to investors that incorporated the fraudulent financial results, including, for example, the Company's January 31, 2001 Fourth Quarter Earnings Release, the Company's January 31, 2001 Investor Day Earnings Release Call, the Company's April 18, 2001 Earnings Release, the Company's April 18, 2001 Quarterly Results Call, the Company's July 18, 2001 Second Quarter Earnings Release, the Company's July 18, 2001 Earnings Call, the Company's October 17, 2001 Third Quarter Earnings Release, the Company's October 17, 2001 Earnings Call, and the Company's January 7, 2002 Earnings Call/Analysts' Teleconference. These statements emanated from New York, New York, as did most of the Company's communications with the investing public.

32. Kelly, the CFO of AOL pre-merger and the CFO of the combined company post-merger, knew or was reckless in not knowing that AOL was improperly recognizing revenues from sham transactions that he had approved. Kelly also negotiated two transactions with Bertelsmann, A.G. ("BAG"), AOL's German partner in AOL Europe, which resulted in \$400 million being improperly booked as advertising revenue. Kelly signed public filings that included the Company's materially false and misleading financial results, including Forms 10-Q for the quarterly periods ended September 30,

2000 (filed November 9, 2000); December 31, 2000 (filed March 27, 2001); March 31, 2001 (filed May 15, 2001); and June 30, 2001 (filed August 14, 2001). Kelly also signed the Company's materially false and misleading Form 10-K for the transition period from July 1, 2000 to December 31, 2000 (filed March 27, 2001). For example, the Company's Form 10-Qs for the first and second quarters of 2001 included more than \$80 million in improper advertising revenue from BAG transactions over two quarters. Kelly did not disclose the improper transactions to E&Y, AOL's external auditor.

33. Kelly also made or substantially contributed to various public statements to investors that touted the fraudulent financial results, including, for example, the Company's January 31, 2001 Fourth Quarter Earnings Release, the Company's January 31, 2001 Investor Day Earnings Release Call, the Company's April 18, 2001 Earnings Release, the Company's April 18, 2001 Quarterly Results Call, the Company's July 18, 2001 Second Quarter Earnings Release, the Company's July 18, 2001 Earnings Call, the Company's October 17, 2001 Third Quarter Earnings Release, the Company's October 17, 2001 Earnings Call, and the Company's January 7, 2002 Earnings Call/Analysts' Teleconference. These statements emanated from New York, New York.

34. When Ripp became the CFO of AOL in early 2001, he was told that AOL "grossed-up" certain vendor transactions in exchange for advertising revenue coming back from the vendors in the amount of the "gross-ups." He also knowingly or recklessly took part in and approved AOL's round-trip transactions with BAG and WorldCom, Inc. as described below. Ripp did not disclose these improper transactions to E&Y.

35. Ripp also made or substantially contributed to various public statements to investors that incorporated the fraudulent financial results, including, for example, the

pay for goods or services they did not want or need. The accounting failed to reflect the true economic substance of these transactions and, as intended by the defendants, resulted in the artificial inflation of AOL's reported online advertising revenue and other key financial results.

41. As alleged below, each defendant knew or was reckless in not knowing that: the Company manipulated its business transactions in order to manufacture and recognize online advertising revenues; the advertising revenues from the round-trips were not real advertising revenues; and the Company took steps to conceal the true substance of the round-trip transactions.

42. As a foreseeable and intended result of each of the defendants' actions described below, the Company reported materially false and misleading financial results in periodic reports filed with the Commission and other public statements for at least the period ended September 30, 2000, through the period ended December 31, 2003.

43. The sham advertising transactions described in this Complaint had a material impact on one or more of the important metrics the investing public and analysts considered in evaluating the stock of AOL pre-merger and AOL Time Warner post merger, including AOL's reported advertising and commerce revenue, net income, operating income, and EBITDA (earnings before interest, tax, depreciation and amortization).

44. For example, from at least 2000 through at least the end of 2002, analysts and the financial press paid particular attention to AOL's advertising and commerce revenue and top executives of AOL and later AOL Time Warner, including Kelly and Ripp, touted these results on earnings and analyst calls, as well as in press releases. Most, if not

all, of these communications with the investing public, including analyst calls, earnings calls, and press releases, emanated from New York, New York.

45. AOL's advertising and commerce revenue was singled out in public statements and press releases issued by the Company on multiple occasions in 2001 and 2002. Kelly himself made at least three public statements to analysts referencing the growth of AOL's advertising and commerce revenue, including statements on April 18, 2001, July 18, 2001, and October 17, 2001.

46. By transmitting to corporate headquarters the division's financial results (inflated by the BAG and other deals), Ripp substantially contributed to the above statements to investors. He also made at least one statement to investors of his own, in a January 2, 2002 AOL Time Warner Conference, incorporating 2002 results and projections for revenue, advertising and commerce revenue, and EBITDA. These statements emanated from New York, New York.

47. As a result of the defendants' actions detailed in this Complaint, AOL materially inflated its advertising and commerce revenue in each of the fourteen quarters from the quarter ended September 30, 2000 through the fourth quarter of 2003. Manipulating and mischaracterizing business transactions described in this Complaint in order to artificially boost AOL's financial results also helped to close the gap between actual results and market expectations. As alleged above, Kelly, Rindner, Ripp, and Wovsaniker also made or substantially contributed to various public statements to investors that incorporated the fraudulent financial results.

execute the plan to forgo the additional 15% purchase discount from Sun and convert it into a purported online advertising sale to Sun.

57. Contemporaneous June 2000 internal Sun e-mails confirmed that AOL told Sun that AOL needed revenue back from Sun -- instead of a discount -- in exchange for its equipment purchase commitment and that AOL understood the revenue back represented the forgone additional 15% discount.

58. Sun rejected AOL's first proposal to convert the discount into AOL advertising revenue. Instead, Sun offered to give free equipment that AOL could resell or lease for at least the amount of the forgone discount and thereby generate the revenues that AOL sought. When Wovsaniker learned of Sun's proposal, he intervened and told Sun that its proposed deal structure would not provide the advertising revenue AOL needed.

59. A June 19, 2000 internal Sun e-mail contemporaneously confirmed what Wovsaniker and others at AOL explained to Sun, namely that "AOL does not believe they can recognise [sic] revenue on the sale of 'free' equipment so that does not seem an option."

60. With Wovsaniker's knowledge and approval, AOL and Sun ultimately agreed that in exchange for AOL's commitment to purchase \$250 million of equipment from Sun, Sun would agree to "buy" \$37.5 million of advertising from AOL. (The \$37.5 million was the amount of the forgone additional discounts Sun was willing to give AOL). Sun did not want to pay cash for the advertising and insisted on using the previously proposed free equipment as payment for the advertising. In or about June 2000, Wovsaniker and Kelly approved an accounting for the Sun transaction in which

AOL improperly recognized the converted, forgone discounts as advertising revenue and accepted free equipment from Sun *in lieu* of cash for the advertising.

61. The Sun transaction was documented in two apparently separate and independent contracts – an equipment contract and an advertising contract – neither of which reflected the fact that AOL converted the free \$37.5 million worth of equipment into a purported purchase of \$37.5 million of online advertising.

62. The advertising contract provided AOL, and not the purported advertising client, Sun, with nearly complete control over the advertising. It also provided AOL with absolute discretion to run the advertising “at any time AOL deems appropriate.”

63. As the September 2000 quarter was nearing its close, AOL projected an advertising revenue shortfall. To close the revenue gap, Kelly and others obtained Sun’s permission to exceed a contractual provision limiting AOL to running \$25 million of advertising in any one quarter. In a late August 2000 e-mail, a Business Affairs executive explained that AOL viewed obtaining the additional \$12.5 million in Sun advertising revenue as the “lynchpin” to AOL’s ability to make its quarterly numbers.

64. In November 2000, during its September 2000 quarterly review of AOL’s financial statements, E&Y learned that AOL had sought and obtained Sun’s permission to exceed the contractual provision limiting AOL to running \$25 million of advertising per quarter and that there was no corresponding written amendment as of the end of the September quarter. E&Y told Wovsaniker that these facts caused it to question the legitimacy of the advertising transaction and asked Wovsaniker whether he was aware of any discussion related to increasing the price of the equipment purchase in exchange for an advertising agreement. Wovsaniker denied being aware of any such discussion. He

had no budget or need for AOL's online advertising at the time and Veritas doubted whether advertising on AOL furthered its advertising objectives.

71. By mid-September 2000, AOL and Veritas had agreed on a \$30 million purchase price for the license, which represented a 65% discount. Veritas and AOL agreed to close the transaction by quarter-end of September 30, 2000.

72. In late September, about a week before the deal was set to close, AOL's Business Affairs unit intervened in order to try to extract advertising revenue from the transaction. During that time, Business Affairs consulted with Wovsaniker on how to structure the deal in order to achieve advertising revenue recognition. On the morning of September 29, 2000, Business Affairs internally described its efforts as "trying to get [Veritas] to trade a lower discount for an ad deal (no net benefit to anyone) . . ."

73. On or about September 29, 2000, the day the parties planned to sign the license agreement, AOL executives, following the round-trip model employed in the Sun transaction, contacted Veritas' CEO and proposed, as a favor to AOL, that Veritas allow AOL to pay an additional \$20 million for the license in exchange for Veritas' agreement to purchase a comparable amount of AOL online advertising. AOL explained that it would simply take a "shallower" (less favorable) discount on the license purchase price.

74. Shortly thereafter, Veritas agreed to accept \$50 million for the license and to enter simultaneously into a \$20 million advertising contract with AOL.

75. Business Affairs implemented the round-trip transaction, changing the price in the contract to \$50 million and, following Wovsaniker's advice, drafting separate deal summaries for the license and advertising contract to make it appear that the license and advertising deals were two separate, *bona fide* and non-contingent transactions. The

terms of the license remained essentially unchanged despite the \$20 million increase in the price.

76. On or about September 29, 2000, Wovsaniker approved the transaction. Wovsaniker advised that the purchase of software and sale of advertising should be documented as if they were two separate and unrelated transactions, when he knew or was reckless in not knowing that they were contingent pieces of a round-trip transaction used to improperly inflate AOL's advertising revenues.

77. In internal AOL e-mails sent on and around January 15, 2001, and during E&Y's year-end audit of AOL's financial statements, Wovsaniker was told that AOL still had no advertising carriage plan in place for Veritas but nonetheless had already recognized \$7 million of advertising revenue from Veritas.

78. On January 17, 2001, Rindner sent an e-mail to a Business Affairs employee (with a copy to Wovsaniker), reprimanding the Business Affairs employee for stating in an e-mail to Wovsaniker that no advertising carriage plan was in place. Rindner instructed the employee to "clean this up", stating that "we are all aware that there was no carriage plan in place prior to signing the deal – it was [To Be Determined] at our discretion."

79. The next day, E&Y spoke with Wovsaniker to discuss an open item in its audit – the appropriate accounting treatment for the Veritas transaction. E&Y told Wovsaniker that it needed to test the fair value of the license and advertising transactions because they were executed simultaneously.

80. Wovsaniker lied to and/or misled E&Y, telling the auditors that the deals were fairly valued. Moreover, the license summary sign-off page that referenced the

89. With Wovsaniker's advice and assistance, in November 2000, AOL entered into a transaction with HP to obtain \$12 million of online advertising revenue in exchange for agreeing to forgo a similar amount of additional discounts that AOL had negotiated in connection with a commitment to purchase \$200 million in hardware.

90. Following Wovsaniker's guidance, Business Affairs executives falsely documented the transaction as if AOL's hardware purchase commitment and HP's agreement to purchase advertising were separate, *bona fide* transactions. AOL "explained" to HP that AOL's accounting department would not allow the two contracts to be linked. In an internal HP e-mail dated October 12, 2000, an HP negotiator wrote that "AOL is still concerned about the SEC ruling and their accounting department will not allow them to be linked together."

91. The Business Affairs executives likewise prepared separate deal summaries for the equipment purchase and advertising sale, thereby concealing the true nature and substance of the transaction and the fact that AOL was paying a higher price for the hardware than it otherwise would have, in order to obtain contingent advertising revenue. They deleted all reference to the advertising transaction in the hardware summary, notwithstanding the fact that the conversion of discounts into advertising dollars had led to the alteration of the terms of the hardware contract. The deal summary stated that "[t]he agreement locks in and extends AOL's aggressive hardware and software discounts . . .", without disclosing that AOL had declined HP's top corporate discount.

92. While the contracts and deal summaries did not document any relationship between the two contracts, Wovsaniker knew or was reckless in not knowing that in

135. Kelly, Ripp, and Wovsaniker improperly approved recognition of the entire \$400 million BAG paid for the put/call amendments as advertising revenue rather than as consideration received for amending the put/call, i.e., as a reduction in the purchase price of AOL Europe.

136. The advertising revenue the AOL division recognized from the first quarter 2001 BAG transaction was identified by Ripp as “a major factor” in helping the division meet corporate expectations about several key financial results. The division’s financial results were then transmitted by Ripp’s group to the parent Company in New York, New York.

137. Kelly then signed the Company’s Forms 10-Q for the first and second quarters of 2001, which, together, included more than \$80 million of sham advertising revenue related to the first quarter BAG deal.

138. The BAG advertising revenue also helped the Company meet or exceed targets in revenue and other key financial results and, later, to minimize any quarterly shortfalls.

139. BAG accounted for the entire \$400 million as a reduction in the price of AOL Europe rather than as an advertising expense.

140. Based upon contemporaneous internal communications and negotiations with BAG in the first quarter of 2001, Kelly knew or was reckless in not knowing that the additional advertising related to the put/call amendments had little value to BAG.

141. Kelly, Ripp, and Wovsaniker knew or were reckless in not knowing that the advertising contracts associated with the put/call amendments stripped BAG of the preferred pricing and terms it enjoyed under an existing \$150 million AOL advertising

agreement, including the means to control the content, placement, and frequency of the advertising.

142. Throughout 2001 and the first half of 2002, Kelly, Rindner, Ripp, and Wovsaniker discussed internally how much BAG advertising revenue to recognize, based upon how much online advertising AOL needed to “close the gap” between market expectations and actual online advertising revenues. For example, a June 29, 2001 e-mail from Ripp to Kelly and Business Affairs (and forwarded to Rindner the next day), indicated, “We have had a miss in commerce and visa revenue. Looks like total ad commerce revenue is is [sic] at \$760. Let me know tomroow [sic] if you need the \$5 million Bag. Still don’t think we should book it but Mike we should talk.” The defendants used the advertising revenue to close the quarterly revenue gaps AOL faced as the online market continued to deteriorate in 2001.

143. To conceal the significance of this sham BAG advertising to the Company’s quarterly reported revenues, Kelly, Rindner, Ripp, and Wovsaniker carefully tracked their recognition of BAG advertising revenue in at least 2001 and 2002 to attempt to ensure that it would not account for more than 10% of the Company’s consolidated revenue – the threshold they believed would require disclosure of this significant aspect of revenue.

144. The sham BAG advertising artificially inflated AOL’s financial results from the first quarter of 2001 through at least the end of 2003, and was reported in public statements and filings. For example, the AOL segment’s advertising and commerce revenue – a key financial result that was separately reported by the Company – was materially inflated by at least \$75 million in each of the first and second quarters of 2002,

159. During the negotiations to restructure the modem service agreement in the first and second quarters of 2001, the amount accrued by AOL continued to increase. As of the end of June 2001, AOL had accrued \$39.2 million for modem service costs withheld from payments to UUNET under dispute.

160. As part of the agreement to restructure the modem service agreement, AOL agreed to extend the agreement, forgo certain discounts, and pay WorldCom only \$5 million of the amount it had withheld for the market-pricing dispute. WorldCom agreed to these changes.

161. Instead of reversing the \$39.2 million accrual and paying WorldCom \$5 million, AOL agreed to pay WorldCom the entire \$39.2 million in return for WorldCom's agreement to pay AOL \$34.2 million for online advertising in June 2001, thereby enabling AOL to inflate its online advertising revenue.

162. During the negotiations, as the difference between the rate AOL was paying for the modems and the rate WorldCom was billing per the contract increased with the passage of time, AOL obtained WorldCom's agreement to a corresponding increase in the purported online advertising purchase.

163. Ripp attended strategy meetings where AOL negotiators discussed the transaction, and he understood that WorldCom had accepted AOL's offer to pay only \$5 million to settle the dispute from February through June 2001. Based upon his participation in these meetings and discussions with deal team members, Ripp knew the details of the transaction and understood that the waived market-pricing disputed amount would be converted (minus \$5 million) into an online advertising sale to WorldCom. Ripp approved the transaction and revenue recognition for the arrangement.

164. Wovsaniker was consulted and provided advice on the transaction from approximately April through June 2001. Based upon these consultations, he understood that the advertising deal was contingent on the restructured network deal and the settlement of the pricing dispute, but nevertheless approved the structure and accounting for this transaction that was not in conformity with GAAP.

165. AOL's internal deal summary, reviewed by Wovsaniker, Ripp, and others, disclosed the agreement to pay \$39.2 million but not the contingent \$34.2 million ad contract. The "Deal Economics" section disclosed the \$39.2 million payment as a settlement, but failed to disclose the actual agreement to pay only \$5 million to settle and the subsequent agreement to pay an additional \$34.2 million in return for a \$34.2 million advertising deal.

166. Rindner knew or was reckless in not knowing that WorldCom did not want or need this advertising. Contemporaneous e-mails sent or received by Rindner showed that WorldCom delayed its agreement to the advertising piece of the round-trip until it had extracted concessions from AOL. As a result, and in order to recognize revenue from this deal in the second quarter of 2001, Rindner ran advertising for WorldCom in June 2001, even before WorldCom agreed to enter into an advertising contract.

167. In or after July 2001, Wovsaniker learned E&Y was auditing the WorldCom network deal and had asked the Company to identify comparable costs to support the accounting. Wovsaniker did not disclose to E&Y the true, contingent nature of the transaction. He also failed to disclose the agreement by AOL to pay the otherwise waived penalty as part of the restructured network deal and WorldCom's agreement to purchase advertising for the same amount.

don't need them. etc, etc . . . this has turned into a money changing scheme and it can't continue

172. AOL and WorldCom agreed to a round-trip transaction, where AOL agreed to pay the \$17 million penalty accrued by AOL that WorldCom previously offered to waive, in exchange for WorldCom's agreement to an additional \$17 million advertising deal. As the actual shortfall and related penalty amount could not be determined until after the calendar year-end, Rindner and others agreed to review the actual penalty in excess of \$17 million (then estimated to be \$25 million) with WorldCom in January 2002. WorldCom agreed to also waive that amount, once determined, and incorporate that value into another round-trip deal in a similar manner – namely, AOL would pay the amount waived in exchange for another purported advertising sale.

173. Rindner, together with others, structured and negotiated the transaction, including drafting e-mails for his boss's use in his negotiations with WorldCom and directly negotiating with his counterpart at WorldCom, receiving e-mails such as the November 5, 2001 e-mail referenced above, supervising the internal approval process for the advertising deal summary, and signing the advertising contracts. Rindner therefore knew or was reckless in not knowing that the deal summary did not reflect the true nature of the parties' agreement – that is, that the \$17 million advertising purchase was merely a return of a \$17 million penalty payment that WorldCom had waived. Rindner nevertheless directed the drafting of the deal documents and summaries as if there were separate, *bona fide* transactions, with AOL Europe paying \$17 million of the shortfall owed by CompuServe, AOL agreeing to extend the voice/data deal for one year, and WorldCom entering a purportedly independent \$17 million online advertising purchase with AOL.

