

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q/A**

**Amendment No. 1**

(Mark One)



**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2004**



**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

**Or**

**For the transition period from                      to**

**Commission file number 000-32979**



**COMMERCE ONE, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**94-3392885**

(IRS Employer  
Identification Number)

**One Market Street  
Steuart Tower, Suite 1300  
San Francisco, CA 94105**

(Address of principal executive offices including zip code)

**(415) 644-8700**

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☒ No ☐

As of April 15, 2004, there were 36,661,038 shares of the registrant's Common Stock outstanding.

## **EXPLANATORY NOTE**

This Amendment No. 1 to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2004 is being filed in order to revise the value of the contingent beneficial conversion feature on the promissory notes we issued on December 31, 2003. This Form 10-Q/A does not attempt to modify or update any other disclosures set forth in the original filing, except as required to reflect the changes noted above. Additionally, this Form 10-Q/A does not purport to provide a general update or discussion of any other developments at the Company subsequent to the original filing. The filing of this Form 10-Q/A shall not be deemed an admission that the original filing, when made, included any untrue statement of material fact or omitted to state a material fact necessary to make a statement not misleading.

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# ITEM 1. FINANCIAL STATEMENTS

## Commerce One, Inc. Condensed Consolidated Balance Sheets (In thousands, except share and per share data) (unaudited)

	March 31, 2004	December 31, 2003
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents.....	\$ 8,993	\$ 6,943
Restricted cash and short-term investments.....	125	1,623
Accounts receivable, net of allowances of \$0.5 million at March 31, 2004 and \$1.0 million at December 31, 2003.....	1,092	4,984
Prepaid expenses and other current assets.....	3,290	2,991
Notes receivable.....	2,000	4,009
Total current assets.....	15,500	20,550
Restricted cash, cash equivalents, and short-term investments.....	1,108	1,569
Property and equipment, net.....	345	511
Other intangible assets, net.....	2,063	2,262
Investments and other assets.....	2,198	4,356
Total assets.....	\$ 21,214	\$ 29,248
<b>LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' DEFICIT</b>		
Current liabilities:		
Accounts payable.....	\$ 961	\$ 1,064
Accrued compensation and related expenses.....	539	1,041
Deferred revenue.....	2,758	4,098
Notes payable.....	3,321	--
Other current liabilities.....	3,931	5,199
Total current liabilities.....	11,510	11,402
Notes payable.....	--	2,777
Non-current accrued restructuring charges and other non-current liabilities.....	82	388
Warrant liability.....	2,682	5,229
Commitments and contingencies		
Redeemable convertible preferred stock.....	12,480	12,480
Stockholders' deficit:		
Common Stock, par value \$0.0001, 950,000,000 shares authorized; 36,689,852 and 33,558,063 issued and outstanding at March 31, 2004 and December 31, 2003, respectively.....	3,691,983	3,686,044
Note receivable from stockholder.....	(129)	(129)
Accumulated other comprehensive loss.....	(144)	(113)
Accumulated deficit.....	(3,697,250)	(3,688,830)
Total stockholders' deficit.....	(5,540)	(3,028)
Total liabilities, redeemable convertible preferred stock and stockholders' deficit.....	\$ 21,214	\$ 29,248

See accompanying notes to condensed consolidated financial statements.

**Commerce One, Inc.**  
**Condensed Consolidated Statements of Operations**  
(In thousands, except per share data)  
(unaudited)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2004</b>	<b>2003</b>
<b>Revenues:</b>		
License fees.....	\$ 272	\$ 2,248
Services.....	2,435	10,861
Total revenues(1).....	<u>2,707</u>	<u>13,109</u>
<b>Costs and expenses:</b>		
Cost of license fees(2).....	293	305
Cost of services.....	1,384	8,858
Sales and marketing.....	1,222	7,911
Product development.....	1,932	11,394
General and administrative.....	2,833	2,382
Stock compensation.....	--	1,047
Restructuring costs, net of reversals.....	(250)	10,941
Amortization of intangible assets.....	199	149
Total costs and expenses.....	<u>7,613</u>	<u>42,987</u>
Loss from operations.....	<u>(4,906)</u>	<u>(29,878)</u>
Interest income and other, net.....	(1,757)	1,052
Interest expense.....	(620)	(264)
Loss before income taxes.....	<u>(7,283)</u>	<u>(29,090)</u>
Provision for income taxes.....	<u>--</u>	<u>(238)</u>
Net loss.....	(7,283)	(29,328)
Common shares and cash issued to BayStar.....	(1,152)	--
Net loss attributable to common stockholders.....	<u>\$ (8,435)</u>	<u>\$ (29,328)</u>
Basic and diluted net loss per share attributable to common stockholders.....	<u>\$ (0.28)</u>	<u>\$ (1.00)</u>
Shares used in calculation of basic and diluted net loss per share.....	<u>30,431</u>	<u>29,263</u>
(1) Revenues from SAP, Covisint and NTT (Note 7).....	<u>\$ 81</u>	<u>\$ 1,726</u>
(2) Includes charges for the impairment and amortization of the technology agreement with Covisint ("Technology Agreement").....	<u>\$ --</u>	<u>\$ 498</u>

See accompanying notes to condensed consolidated financial statements.

**Commerce One, Inc.**  
**Condensed Consolidated Statement of Cash Flows**  
(In thousands)  
(unaudited)

	Three Months Ended	
	March 31,	
	2004	2003
Operating activities:		
Net loss.....	\$ (7,283)	\$ (29,328)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization.....	229	1,640
Amortization of Technology Agreement with Covisint.....	--	498
Amortization of deferred stock compensation.....	--	1,047
Amortization of intangible assets.....	199	149
Non-cash interest expense accretion on note payable to ComVest.....	543	--
Mark to market - warrant liability.....	2,349	--
Loss on investments.....	--	(3)
Change in operating assets and liabilities:		
Restricted investments.....	502	(5,010)
Accounts receivable, net.....	3,892	(1,750)
Prepaid expenses and other current assets.....	43	(2,875)
Accounts payable.....	(103)	1,717
Accrued compensation and related expenses.....	(502)	(2,683)
Other liabilities.....	(1,775)	(4,628)
Deferred revenue.....	(1,340)	(2,033)
Net cash used in operating activities.....	<u>(3,246)</u>	<u>(43,259)</u>
Investing activities:		
Purchases of property and equipment, net.....	(79)	(162)
Proceeds from the sale of property and equipment.....	--	483
Purchases of short term investments.....	(162)	(24)
Proceeds from the maturity of short term investments.....	1,628	5,659
Proceeds (use of cash) from divestitures of operations.....	--	(431)
Other.....	--	131
Net cash provided by investing activities.....	<u>1,387</u>	<u>5,656</u>
Financing activities:		
Proceeds from issuance of common stock, net.....	92	--
Proceeds from issuance of notes payable and exercise of warrants.....	3,815	--
Net cash provided by financing activities.....	<u>3,907</u>	<u>--</u>
Effect of foreign currency translation on cash and cash equivalents.....	2	(81)
Net increase (decrease) in cash and cash equivalents.....	2,050	(37,684)
Cash and cash equivalents at beginning of period.....	6,943	73,753
Cash and cash equivalents at end of period.....	<u>\$ 8,993</u>	<u>\$ 36,069</u>
Supplemental disclosures of cash flow information:		
Interest paid.....	\$ 75	\$ 234
Non-cash investing and financing activities:		
Issuance of common stock to BayStar.....	\$ 952	\$ --
Reclassification of warrant liability to Common Stock upon warrant exercise (Note 9).....	<u>\$ 4,895</u>	<u>\$ --</u>

See accompanying notes to condensed consolidated financial statements.

**Commerce One, Inc.**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Description Of Business**

Commerce One is a technology company that specializes in software and services that allow companies to conduct business more efficiently through composite process management. The goal of composite process management is to make business processes and interactions more efficient and to automate business functions. Composite process management allows organizations to create new applications with new features and capabilities from their existing software applications. The resulting applications (called "composite applications") combine the different functionality of stand-alone software applications into a unified business process, allowing the customer to automate relationships both inside and outside the company. The Commerce One Conductor™ platform is designed to allow companies to collaborate more efficiently with their partners, customers and suppliers by automating their critical business processes. The platform has broad applicability in a wide variety of industries. Examples of business functions that can be automated using the Commerce One Conductor platform include procurement and supplier sourcing functions, spend analysis and payment and supply chain processes across industries such as automotive, manufacturing, health care and consumer goods.

**Basis Of Presentation**

At March 31, 2004, the Company had \$10.2 million cash and cash equivalents and investments, of which \$9.0 million was unrestricted and available to fund operations, positive working capital of \$4.0 million and a \$3.7 billion accumulated deficit. To date, the Company has funded its operations from revenue, debt and equity financing, including the issuance of notes payable, warrants and redeemable preferred stock.

The Company has taken significant steps to reduce its expenses through personnel reductions and other cost reduction measures, including personnel reductions that reduced headcount to 101 by March 31, 2004, and multiple real estate settlement agreements that significantly reduced prospective rental expenses. While these efforts have significantly reduced the Company's expense levels, its operations are still drawing upon its cash reserves.

The Company's continued viability is dependent on its ability to generate revenues through sales of its Commerce One Conductor platform and composite process management solutions and to generate increasing revenues through sales of SRM products and services.

The Company is building the market opportunity for its Commerce One Conductor platform. The Conductor platform was released in early 2003 and sales of the platform thus far have not been significant. Although there can be no assurance that such efforts will increase Conductor revenues, the Company has hired a sales force focused on direct license sales of the Commerce One Conductor platform and related composite process management applications and released a new version of the Commerce One Conductor platform with enhanced functionality in October 2003.

In its most recent filings, the Company indicated that it was considering the sale of its Supplier Relationship Management (SRM) assets to generate additional necessary working capital. While there can be no assurance that the Company will not sell these assets in the future, the Company is not currently actively looking to sell its SRM assets. Currently, the Company plans to continue generating revenue through the direct license sales of SRM products and related services in conjunction with its direct license sales efforts relating to the Conductor platform. SRM revenues have been declining during the past 12 months. Although there can be no assurance that such efforts will increase SRM revenues, the Company plans to dedicate sales efforts focused on the SRM applications and is creating a product development plan to enhance the SRM products.

The Company believes that based on its current plans and expectations, it will have sufficient resources to meet its operating, working capital, investing and financing requirements for the 2004 fiscal year. However, the Company's \$5.0 million promissory notes with ComVest and DCC Ventures are due on March 31, 2005 and the Company owes Peoplesoft approximately \$2.1 million payable on February 22, 2005. As a result of these debt obligations, Commerce One believes that it will need to raise up to an additional \$7.0 million in order to meet its \$7.1 million repayment obligations.

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the

accompanying interim unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary to summarize fairly the consolidated financial position, results of operations and cash flows for such periods. The results for the interim period ended March 31, 2004 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2004 or for any future periods.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation. Certain previously reported amounts have been reclassified to conform to the current presentation format.

The functional currency of the Company's foreign subsidiaries is the local currency. The Company translates all assets and liabilities to U.S. dollars at the current exchange rates as of the applicable balance sheet date. Revenue and expenses are translated using the average exchange rate for the period. Gains and losses resulting from the translation of the foreign subsidiaries' financial statements are reported as a separate component of accumulated comprehensive other income (loss) in stockholders' equity. Net gains and losses resulting from foreign exchange transactions, which are recorded in the statement of operations, were not significant during any of the periods presented.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Commerce One Annual Report on Form 10-K for the year ended December 31, 2003.

### Stock-Based Compensation

The Company generally has three categories of employee stock-based awards: restricted stock, stock options and a stock purchase plan. The Company accounts for employee stock options using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25) and has adopted the disclosure-only alternative of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation" as amended. Under the intrinsic value method, the Company has only recorded stock-based compensation resulting from restricted stock issued and options assumed in various prior period acquisitions.

Restricted stock is measured at fair value on the date of grant based on the number of shares granted and the quoted price of the Company's common stock. Such value is recognized as an expense ratably over the corresponding employee service period. To the extent restricted stock or restricted stock units are forfeited prior to vesting, any corresponding previously recognized expense is reversed as an offset to "Stock-based compensation."

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123 as amended by SFAS 148 to stock-based employee compensation (in thousands except per share data):

	Three Months Ended	
	March 31,	
	2004	2003
Net loss attributable to common stockholders - as reported.....	\$ (8,435)	\$ (29,328)
Add: Stock-based compensation cost, included in the determination of net income as reported.....	--	1,047
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards.....	(552)	(4,077)
Proforma net loss.....	<u>\$ (8,987)</u>	<u>\$ (32,358)</u>
Loss per share:		
Basic and diluted - as reported.....	<u>\$ (0.28)</u>	<u>\$ (1.00)</u>
Basic and diluted - pro forma.....	<u>\$ (0.30)</u>	<u>\$ (1.11)</u>

The weighted-average fair value for stock options granted were calculated using the Black-Scholes option-pricing model based on the following assumptions:



	2004	2003
Volatility.....	94 %	88 %
Weighted-average estimated life - stock options.....	3 years	3 years
Weighted-average estimated life - stock purchase plan.....	6 months	6 months
Weighted-average risk - free interest rate.....	1.9 %	2.3 %
Dividend yield.....	--	--

## Recent Accounting Pronouncements

In November 2003, the Emerging Issues Task Force (EITF) Issue No. 03-6 "Participating Securities and the Two-Class Method under FASB Statement No. 128," which provides for a two-class method of calculating earnings per share computations that relate to certain securities that would be considered to be participating in conjunction with certain common stock rights. This guidance would be applicable to the Company as of the quarter ending September 30, 2004. The Company is currently evaluating the potential impact of this pronouncement on its financial statements.

## 2. RESTRICTED INVESTMENTS

As of March 31, 2004, cash, cash equivalents, and short-term investments of approximately \$1.2 million were restricted by certain obligations of Commerce One related to real estate and potential workers' compensation claims.

## 3. BASIC AND DILUTED NET LOSS PER SHARE

Basic and diluted net loss per share information for all periods is presented under the requirements of SFAS No. 128, "Earnings per Share." Basic earnings per share has been computed using the weighted-average number of shares of common stock outstanding during the period, less shares that may be repurchased and excludes any dilutive effects of options, warrants, and convertible securities. Potentially dilutive issuances have also been excluded from the computation of diluted net loss per share, as their inclusion would be anti-dilutive.

The calculation of basic and diluted net loss per share is as follows (in thousands, except per share amounts):

	Three Months Ended	
	March 31,	
	2004	2003
Net loss attributable to common stockholders.....	\$ (8,435)	\$ (29,328)
Weighted average shares of common stock outstanding.....	30,431	29,275
Less: Weighted average shares subject to to repurchase and forfeiture.....	--	(12)
Weighted average shares of common stock outstanding used in computing basic and diluted net loss per share.....	30,431	29,263
Basic and diluted net loss per share.....	\$ (0.28)	\$ (1.00)

## 4. COMPREHENSIVE INCOME (LOSS)

SFAS 130, "Reporting Comprehensive Income," established standards of reporting and display of comprehensive income and its components of net income and "Other Comprehensive Income." "Other Comprehensive Income" refers to revenues, expenses and gains and losses that are not included in net income but rather are recorded directly in stockholders' equity. The components of comprehensive loss for the three months ended March 31, 2004 and 2003 were as follows (in thousands):

	Three Months Ended	
	March 31,	
	2004	2003
Net loss attributable to common stockholders.....	\$ (8,435)	\$ (29,328)
Unrealized loss on investments.....	--	(3)
Foreign currency translation adjustment.....	(15)	(104)
Comprehensive loss.....	<u>\$ (8,450)</u>	<u>\$ (29,435)</u>

## 5. RESTRUCTURING COSTS

In January 2003, the Company adopted SFAS 146, “*Accounting for Costs Associated with Exit or Disposal Activities*” for all restructuring plans initiated after December 31, 2002. SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue 94-3 “*Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*.” SFAS 146 requires that a liability for costs associated with an exit or disposal activity be recognized at fair value when the liability is incurred, not at the date of an entity’s commitment to an exit plan as required under EITF Issue 94-3. Subsequent to initial recognition at fair value, restructuring liabilities are accreted to their estimated settlement amounts. Prior to January 1, 2003, the Company accounted for restructuring activities under EITF 94-3 and, as required under SFAS 146, continues to use EITF 94-3 to account for liabilities related to restructuring plans initiated prior to January 1, 2003. All restructuring charges have been reflected in “Restructuring costs” in the consolidated statement of operations.

### 2003 Restructuring Plans

The following tables summarize the activity related to restructuring plans initiated in 2003, and accounted for in accordance with FAS 146, for the three months ended March 31, 2003 and 2004 (in thousands):

#### 2003 Restructuring Activities

	Accrued restruc- turing costs at December 31, 2002	Amounts charged to restruc- turing costs and other	Amounts paid or written off	Accrued restruc- turing costs at March 31, 2003
January 2003 Plan:				
Lease cancellations and commitments.....	\$ --	\$ 137	\$ --	\$ 137
Termination payments to employees and related costs.....	--	10,085	(5,616)	4,469
Write-off on disposal of assets and related costs.....	--	81	(81)	--
Total restructuring accrual and other.....	<u>\$ --</u>	<u>\$ 10,303</u>	<u>\$ (5,697)</u>	<u>\$ 4,606</u>

#### January 2003 Plan

In January 2003, management approved and began to implement a restructuring plan aimed at further reducing its operating expenses while continuing to align Commerce One’s resources around its core product initiatives. This first quarter activity was intended to reduce the Company’s headcount by approximately 430 employees and payroll related expenses by \$53 million annually. In the first quarter of 2003, the Company recorded approximately \$10.3 million to restructuring charges, primarily in relation to severance pay, continued benefits, and outplacement services. Of this accrued amount, approximately \$5.7 million was paid during the quarter ended March 31, 2003.

#### 2004 Restructuring Activities

	Accrued restruc- turing costs at December 31, 2003	Amounts charged to restruc- turing costs and other	Amounts reversed	Amounts paid or written off	Accrued restruc- turing costs at March 31, 2004
January 2003 Plan:					
Lease cancellations and commitments.....	\$ 814	\$ --	\$ (250)	\$ (564)	\$ --
	<u>814</u>	<u>--</u>	<u>(250)</u>	<u>(564)</u>	<u>--</u>
October 2003 Plan:					
Termination payments to employees and related costs.....	1,412	--	--	(831)	581
Write-off on disposal of assets and related costs.....	204	--	--	(123)	81
	<u>1,616</u>	<u>--</u>	<u>--</u>	<u>(954)</u>	<u>662</u>
Total restructuring accrual and other.....	\$ <u>2,430</u>	\$ <u>--</u>	\$ <u>(250)</u>	\$ <u>(1,518)</u>	\$ <u>662</u>

#### January 2003 Plan

In April 2003, in connection with the headcount reductions made under the January 2003 Plan, the Company entered into an agreement to terminate its Cambridge, Massachusetts office lease agreement by paying \$750,000 cash, and agreeing to make two additional cash payments of \$375,000 each to be paid in September 2004 and September 2005, respectively. As a result, the Company recorded a \$1.5 million charge to restructuring in 2003 and established a restructuring liability for the additional cash payments. In January 2004, the Company settled the two future payments of \$375,000 for one payment of \$500,000 payable in January 2004. This \$500,000 final payment was made to the landlord in January 2004 and the net savings of this renegotiation of \$250,000 was recorded as a reversal to restructure expense in the first quarter of 2004. In addition, approximately \$64,000 was paid as a final payment during the three months ended March 31, 2004 on another existing lease.

As a result of final payments made to landlords in the first quarter of 2004, all real estate activities and payments under this plan were completed by March 31, 2004.

#### October 2003 Plan

In October 2003, the Company continued to rationalize its operating expenses by implementing additional restructuring initiatives. The initiatives mainly focused on reducing worldwide headcount to 116 employees by the end of the fourth quarter of 2003 and to reduce payroll related expenses by \$10 million annually. The remaining employee termination accrual of \$1.4 million as of December 31, 2003 primarily related to payments to be made in 2004 in accordance with applicable French laws governing termination payments to employees. During the quarter ended March 31, 2004, the Company paid approximately \$0.8 million to terminated French employees in the form of salary and severance pay. In addition, approximately \$0.1 million was paid in connection with the disposal of assets associated with the French subsidiary.

The Company expects that the remaining liability of \$0.7 million at March 31, 2004 for the October 2003 Plan will be paid in full by December 31, 2004.

### **2002 Restructuring Plans**

In 2002, the Company implemented multiple restructuring plans (the "Plans") aimed at significantly reducing its operating expenses while realigning Commerce One's resources around its core product initiatives. The Plans included costs such as separation pay, outplacement services and benefit continuation, as well as the termination of certain office leases, the divestiture of certain parts of Commerce One's Global Services division, the consolidation or closure of certain facilities and the write-down of the carrying value of computers and equipment used by employees who were terminated.

The following tables summarize the activity related to the restructuring plans initiated prior to January 1, 2003, and accounted for in accordance with EITF 94-3, for the three months ended March 31, 2003 and 2004 (in thousands):

*2003 Restructuring Activities*

	<b>Accrued restruc- turing costs at December 31, 2002</b>	<b>Amounts charged to restruc- turing costs and other</b>	<b>Amounts reversed</b>	<b>Amounts paid or written off</b>	<b>Accrued restruc- turing costs at March 31, 2003</b>
Lease cancellations and commitments.....	\$ 34,744	\$ --	\$ --	\$ (4,492)	\$ 30,252
Termination payments to employees and related costs.....	1,513	800	(68)	(2,162)	83
Write-off on disposal of assets and related costs.....	113	--	(94)	(10)	9
Total restructuring accrual and other.....	<u>\$ 36,370</u>	<u>\$ 800</u>	<u>\$ (162)</u>	<u>\$ (6,664)</u>	<u>\$ 30,344</u>
Less non-current accrued restructuring charges.....					(19,789)
Accrued restructuring charges included within other accrued liabilities.....					<u>\$ 10,555</u>

The charge to restructuring for employee-related costs of approximately \$0.8 million was due to a change in management estimates related to employee benefits plans adopted prior to January 1, 2003. Restructuring charges reversed in the quarter ended March 31, 2003 resulted from changes in management estimates relating to employee claims and the disposal price of equipment and other assets. The remaining accrued restructuring costs for Plans adopted prior to January 1, 2003 relate primarily to lease payments contractually required of the Company on certain facilities, net of any estimated sublease amounts, expiring at various dates through 2011.

*2004 Restructuring Activities*

	<b>Accrued restruc- turing costs at December 31, 2003</b>	<b>Amounts charged to restruc- turing costs and other</b>	<b>Amounts paid or written off</b>	<b>Accrued restruc- turing costs at March 31, 2004</b>
Lease cancellations and commitments.....	\$ 138	\$ --	\$ (35)	\$ 103
Accrued restructuring charges included within other current liabilities.....				<u>\$ 103</u>

During the three months ended March 31, 2004, approximately \$35,000 was paid to landlords for continued lease payments on facilities under lease through the end of 2004, net of sublease income. All amounts accrued under this plan will be paid in full by December 31, 2004.

## 6. COMMITMENTS AND CONTINGENCIES

### Commitments

The Company leases its principal office facilities under non-cancelable operating leases. Future minimum payments under operating leases, net of any contracted third-party sub-lease rental income at March 31, 2004 are as follows (in thousands):

	<b>Operating leases</b>
Nine months ending December 31, 2004.....	\$ 1,196
Year ended December 31,	
2005.....	1,526
2006.....	1,382
2007.....	1,322
2008.....	187
Total estimated cash flows.....	\$ 5,613

## Guarantees

In November 2002, the FASB issued FIN No. 45, “*Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others -- an interpretation of FASB Statements No. 5, 57 and 107 and rescission of FIN 34.*” The following is a summary of the Company's agreements that the Company has determined are within the scope of FIN 45.

Under its bylaws and certain agreements with officers and directors, the Company has agreed to indemnify its officers and directors for certain events or occurrences arising as a result of the officer or director's serving in such capacity. The term of the indemnification period is for the officer's or director's lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. However, the Company has a directors and officer liability insurance policy that limits its exposure and enables it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is minimal and has no liabilities recorded for these agreements as of March 31, 2004.

The Company enters into indemnification provisions under (i) its agreements with other companies in its ordinary course of business, typically with business partners, contractors, and customers, landlords and (ii) its agreements with investors. Under these provisions, the Company generally indemnifies and holds harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of the Company's activities or, in some cases, as a result of the indemnified party's activities under the agreement. These indemnification provisions often include indemnifications relating to representations made by the Company with regard to intellectual property rights, and often survive termination of the underlying agreement. In addition, in some cases, the Company has agreed to reimburse employees for certain expenses and to provide salary continuation during short-term disability. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions is unlimited. The Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of March 31, 2004.

The Company's software license agreements also generally include a performance guarantee that the Company's software products will substantially operate as described in the applicable program documentation for a period of 90 days after delivery. The Company also generally warrants that services that the Company performs will be provided in a manner consistent with reasonably applicable industry standards. Costs associated with these warranties are not expected to be material in nature and are expensed as incurred.

## Legal Proceedings

The Company currently is a party to various legal proceedings, including those noted below. While the Company currently believes that the ultimate outcome of these proceedings will not have a material adverse effect on our results of operations, litigation is subject to inherent uncertainties, and unfavorable rulings could occur. Depending on the amount and timing, an unfavorable outcome of some or all of these matters could have a material adverse effect on the Company's cash flows, business, results of operations or financial position.

## Securities Litigation

On June 19, 2001, a class-action securities claim, captioned *Cameron v. Commerce One, Inc., et al.*, was filed against Commerce One, several company officers and directors (the Individual Defendants), and the three lead underwriters in the Commerce One initial public offering (IPO) in the United States District Court for the Southern District of New York. Various plaintiffs have filed similar actions asserting virtually identical allegations against more than 200 other companies. The lawsuits against Commerce One and other companies have been coordinated for pretrial purposes with these other related lawsuits and have been assigned the collective caption *In re Initial Public Offering Securities Litigation*.

On April 19, 2002, plaintiffs' lawyers for the coordinated lawsuits filed an amended complaint consisting of a set of "Master Allegations" and individual amended complaints against the various defendants, including Commerce One and the Individual Defendants. The amended complaint alleges violations of Section 11 and Section 15 of the Securities Act of 1933, Section 20(a) of the Securities Exchange Act of 1934 (Exchange Act), and Section 10(b) of the Exchange Act (and Rule 10b-5, promulgated thereunder) as a result of alleged conduct of the underwriters of the IPO to engage in a scheme to under price the IPO and then artificially inflate our stock price in the aftermarket. The complaint seeks unspecified damages on behalf of a purported class of purchasers of common stock between July 1, 1999 and June 15, 2001. On July 15, 2002, the issuer defendants and individual defendants filed an omnibus motion to dismiss addressing issues generally applicable to the defendants as a group. On October 9, 2002, the district court entered an order dismissing all of the living individual Commerce One officers and directors from the case without prejudice. On February 16, 2003, the district court entered an order denying most of the defenses asserted by the defendants in the omnibus motion to dismiss and allowing most of the case to proceed. A proposal has been made for the settlement and release of claims against the issuer defendants, including Commerce One. Under the settlement proposal, the plaintiffs would dismiss the issuer defendants from the lawsuit (including Commerce One and named individual defendants) and continue to pursue their case against the underwriter defendants. In exchange for this dismissal, the D&O insurance carriers would agree to guarantee a recovery by the plaintiffs from the underwriter defendants of at least \$1.0 billion. The Company's Board of Directors has approved Commerce One's participation in the settlement. The settlement remains subject to a number of conditions, including approval of the proposed settling parties and the court. If settlement does not occur, and litigation against Commerce One continues, the Company believes that it has meritorious defenses and intends to defend the case vigorously.

In February 2003, Commerce One, along with its Chief Executive Officer and former Chief Financial Officer, were named as defendants in a similar class-action matter in Florida, *Liu v. Credit Suisse First Boston et al.*, United States District Court, Southern District of Florida. In that case, the plaintiff alleges that various investment banks, issuer companies, and individuals violated securities laws by engaging in a scheme to under-price initial public offerings and then artificially inflate prices of those stocks in the aftermarket. The Commerce One defendants have been dismissed from the case. By court order dated July 16, 2003, the court declined to grant the plaintiff's motion to vacate its order of dismissal, finding that plaintiff lacked good cause for failing to effect service on the dismissed defendants, including Commerce One. This case also has been coordinated with the other similar class-action securities cases pending in New York, including the *Cameron* matter described above, and it remains unclear whether the proposed settlement of those other cases will apply to the claims in the *Liu* matter.

### ***Other Litigation***

In December 2003, the Company entered into a settlement agreement with Covisint pursuant to which Covisint paid the Company \$4,650,000. This payment was received on or before January 2, 2004. In connection with this agreement, the Company's existing technology agreement with Covisint has been cancelled, and Covisint's future payment obligations to the Company under such agreement have terminated.

## **7. TRANSACTIONS WITH SAP, COVISINT AND NTT**

### **SAP**

The Company entered into a strategic relationship with SAP in 2000 to jointly develop, market and sell the MarketSet suite of applications and the Enterprise Buyer procurement applications. In connection with this agreement, the Company also entered into an equity relationship with SAP. This agreement provided that either party licensing the jointly developed products to its customers would owe a royalty to the other party. These products were primarily targeted at electronic marketplace customers. Historically, SAP was instrumental in assisting the Company with selling the jointly developed products to SAP's customer base. From 2000 to 2002, SAP accounted for a significant portion of the Company's license revenue. However, these royalty payments declined in the past two years with the decline of the market for electronic marketplace solutions. In the three months ended March 31, 2004 and 2003, SAP reported royalties to the Company of

approximately \$0 and \$8.7 million, respectively, of which license revenues were approximately \$0 and \$0.4 million, respectively.

Over time, the relationship with SAP has changed and each company has phased out the jointly developed Enterprise Buyer procurement products and replaced such products with its own successor procurement products. In addition, the market for the Marketset suite of products has declined substantially over the past two years with the decline in the electronic marketplace sector. In November 2003, SAP and Commerce One terminated the commercial relationship. As a result, the Company did not recognize any license revenue from SAP in the three months ended March 31, 2004 and does not expect to receive any license revenue in the remainder of 2004 or thereafter.

Historically, the Company has also generated revenue from its relationship with SAP by providing technical customer support and maintenance services to joint customers. This revenue represented approximately 0% and 5% of the Company's support and maintenance revenues in the three months ended March 31, 2004 and 2003, respectively. As a result of the termination of the SAP relationship in November 2003, the Company does not expect to receive revenues, if any, from SAP for technical support and maintenance in the remainder of 2004 or thereafter.

### Covisint

During 2003, 2002 and 2001, the Company recognized revenues with Covisint, LLC (Covisint), a business-to-business electronic marketplace for the procurement of goods and services by automakers, their suppliers and others. The Company holds a two percent equity interest in Covisint. In addition, the Company recently settled a payment dispute with Covisint and terminated the existing Technology Agreement with Covisint in December 2003, and received a total payment of \$4,650,000. \$750,000 of this amount was received on December 31, 2003 and the remainder (approximately \$3.9 million) was received on January 2, 2004. In exchange for such payment, the Company entered into a new license agreement which licenses to Covisint certain software which had been licensed to it under the prior Technology Agreement.

### NTT

During the three months ended March 31, 2004 and 2003, the Company recognized revenue from transactions with NTT Corporation ("NTT"). A member of the Company's Board of Directors currently serves as an executive of an NTT subsidiary.

Amounts included in revenues in the consolidated financial statements in connection with the transactions described above are as follows (in thousands):

		<b>Three Months Ended</b>	
		<b>March 31,</b>	
		<b>2004</b>	<b>2003</b>
Revenues:			
SAP.....	\$	--	\$ 1,520
Covisint.....		--	92
NTT.....		81	114
Total.....	\$	<u>81</u>	<u>\$ 1,726</u>

## 8. BUSINESS DIVESTITURE AND NOTES RECEIVABLE

On January 24, 2003, the Company executed the sale and license of certain assets, including approximately \$1.0 million in customer accounts receivable, and liabilities, including customer commitments, related to CommerceOne.net, the Company's marketplace services business consisting of auction services, subscription services, content services and hosting services, to eScout LLC, a privately held limited liability company. In connection with the closing of this transaction, the Company received notes receivable with an aggregate face value of approximately \$2.0 million, and the right to receive royalty payments over the four years following the closing of no more than \$0.5 million in the aggregate. As a result of this sale, the Company recorded a loss of \$0.2 million in Interest income and other in the consolidated statement of operations in 2003. Royalties received, if any, will be recognized by the Company in the period they are received. The note receivable bears a quarterly interest rate of 1.5% with payments due each quarter with the final payment due on January 24, 2005. Fifteen percent (15%) of the aggregate purchase price was held in escrow until January 2004 as security for any claims related to a breach of the Company's representations, warranties and covenants. During 2003 and 2002, the Company recognized service revenues totaling approximately \$3.2 million and \$11.8 million, respectively, from CommerceOne.net

related services. Subsequent to this sale, Commerce One no longer offers these services and therefore receives no future revenues related to these services.

On January 9, 2002, the Company executed an asset sale agreement with Connective Commerce Company LLC, a Massachusetts limited liability company composed of former Commerce One employees. In connection with this agreement, the Company received cash of approximately \$2.4 million and a note receivable with a face value of approximately \$4.0 million due on December 31, 2004, that bore a quarterly interest rate of 1.75%, receivable on a quarterly basis commencing September 30, 2002. The Company did not recognize any gain or loss at the time of this sale. On October 15, 2002, the Company agreed with Connective Commerce to modify the note agreement to decrease the payments in 2003 and to forgive interest on the principal balance for 2003. Due to the renegotiation of the note and Connective Commerce's deteriorating financial condition, the Company determined that the value of the asset was significantly impaired and reduced the remaining value of the note to zero during the quarter ended December 31, 2002. The charge was taken as expense in the "General and administrative" section of the Consolidated Statement of Operations. In September 2003, the note, along with certain lease obligations of Connective Commerce to Commerce One, was renegotiated and a payment of approximately \$0.6 million was received from Connective Commerce. As a result, the Company recognized approximately \$0.3 million as other income in the Statement of Operations. Due to Connective Commerce's financial position, the Company has not recognized any asset in relation to the renegotiated payment schedule. Any future payments made by Connective Commerce, if any, will be recognized as other income when received.

## **9. NOTES PAYABLE AND WARRANT LIABILITIES**

In December 2003, the Company completed an agreement with the Company's landlord for its former headquarters in Pleasanton, California, Peoplesoft, Inc., to pre-pay the Company's total remaining \$5.6 million rent obligation. Pursuant to this agreement, the Company paid Peoplesoft an initial cash payment of \$1.5 million, an interest-free promissory note in the principal amount of approximately \$2 million, and shares of restricted common stock with a market value of approximately \$2.1 million based upon the issuance price. The approximate \$2 million promissory note is due and payable in February 2005.

On December 31, 2003, the Company issued secured promissory notes in the aggregate principal amount of \$5.0 million (the Notes) and warrants to purchase the Company's common stock (the Warrants) to ComVest and DCC for an aggregate purchase price of \$5 million. Approximately \$1.0 million and \$4.0 million of the total \$5.0 million were received in December 2003 and January 2004, respectively. The Notes bear interest at a rate varying from 6% to 10% over the term of the Notes, are due on March 31, 2005 or sooner upon the occurrence of certain events of default or other events, and are secured by certain assets related to the Company's SRM business and notes payable to the Company by eScout LLC. The Warrants have been fully exercised into an aggregate of 2,568,494 shares (the Warrant Shares) of the Company's common stock, at an exercise price of \$0.0001 per share. Upon an event of default or a merger, a sale or change of control of the Company, or the sale, transfer or disposition of all or substantially all of the Company's assets (other than the sale of the Company's SRM assets), the Notes become convertible, subject to certain limitations, into shares of the Company's common stock at a conversion price based on 90% of the average closing bid price for the 5 trading days immediately following the later of the date of such event and the date of issuance of any press release announcing such event. The value of the contingent beneficial conversion feature of the Notes is approximately \$4.0 million, and represents the value of the additional shares that would be received as a result of a conversion of the \$5.0 million principal amount at a conversion price lower than the market value of the common stock. This value would be recorded as a charge to interest expense in the period the Notes become convertible.

The holders of the Notes and Warrants have registration rights that require the Company to file a registration statement with the Securities and Exchange Commission (SEC) to register the resale of the common stock issuable upon conversion of the Notes or the exercise of the Warrants. Under EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock", the ability to register stock is deemed to be outside of the Company's control. Accordingly, the fair value of the Warrants of \$3.3 million has been recorded as an accrued warrant liability in the consolidated balance sheet at December 31, 2003, and was marked to market at the end of each quarter. The remaining proceeds from the \$5 million note of \$1.5 million are recorded as a discounted note payable at December 31, 2003, and will be amortized up to its stated principal amount using the effective interest rate method over the term of the note. As of March 31, 2004, warrant liabilities consisted of \$2.7 million related to BayStar warrants (see Note 10). A warrant liability of an adjusted \$4.9 million for the ComVest and DCC Ventures warrants was reclassified into equity during the three months ended March 31, 2004 as a result of ComVest and DCC Ventures exercising their warrants during this period. The adjustment to mark the warrant liability to market for the three months ended March 31, 2004 amounted to approximately \$1.7 million and \$0.7 million related to ComVest and DCC Ventures and BayStar, respectively, and such amounts were recorded to other expense.



## 10. REDEEMABLE CONVERTIBLE PREFERRED STOCK

On July 10, 2003, the Company issued 100,000 shares of its Series B Preferred, and five-year warrants to purchase 2,209,945 shares of its common stock in exchange for \$10.0 million in cash. The Series B Preferred is initially convertible into approximately 4,297,748 shares of our common stock at a conversion price of \$2.3268 per share. The exercise price for the warrants is \$2.715 per share.

The holders of the Series B Preferred Stock and warrants have registration rights that require the Company to file a registration statement with the SEC to register resale of the common stock issuable upon conversion of the Series B Preferred Stock and the common stock issuable upon exercise of the warrants. Under the initial agreement with Baystar, in the event the Company was unable to cause the registration statement to be declared effective by January 6, 2004, cash penalties of \$5,000 per day were due to the holders during the period commencing on January 7, 2004 and ending on the date the registration statement is declared effective by the SEC. Under EITF 00-19, the ability to register stock is deemed to be outside of the Company's control. Accordingly, the initial fair value of the warrants of \$3.6 million has been classified as an accrued warrant liability in the consolidated balance sheet, and are marked to market at the end of each quarter.

The initial value attributed to the Series B Preferred Stock of \$6.4 million represents a discount from its face value of \$10 million. In accordance with EITF 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments," which provides guidance on the calculation of a beneficial conversion feature on a convertible instrument, the Company has determined that the Series B Preferred Stock has a beneficial conversion feature of \$3.3 million. The Company recorded this beneficial conversion feature, together with \$3.6 million in adjustment of the preferred stock to its conversion value at date of issuance as a deemed dividend in the three-month period ended September 30, 2003. The carrying value includes \$400,000 of accrued dividends through March 31, 2004.

The Series B Preferred Stock carries certain rights including the right of the holder to elect redemption if the underlying common shares are not registered by a certain date. Under the original agreement with the holder of Series B Preferred Stock, that date was April 5, 2004. On March 14, 2004, the Company completed a Consent and Amendment Agreement with the holder of the Series B Preferred Stock and related warrants to modify the holder's registration rights. The modification provides a 90-day extension to July 5, 2004 of the date upon which the holder can demand redemption in the event the Company is unable to have declared effective and maintain effectiveness of a registration statement with the SEC to register the resale of common stock issuable upon conversion of the Series B Preferred Stock and common stock issuable upon exercise of the warrants. As of March 31, 2004, the total redemption price would have been approximately \$12,685,000. However, redemption is not considered probable, as an initial Registration Statement covering the underlying shares has been filed, and management believes that effective registration can be attained in the remaining time prior to July 5, 2004. Under the Consent and Amendment Agreement, the holder of Series B Preferred Stock also agreed to waive penalties through July 5, 2004 for failure to cause the registration statement to be declared effective of \$5,000 per day. The Series B Preferred Stock is now redeemable at the option of the holder on July 5, 2004, in the event the Company is unable to cause the registration statement to be declared effective prior to that date. As consideration for this agreement, and in full satisfaction of related penalties of \$375,000 incurred by the Company from January 2004 through the date of the modification, the Company paid to the holder \$200,000 on April 1, 2004, and issued the holder 500,000 unregistered shares of the Company's common stock with an approximate value of \$952,000 based on the average closing bid price of the Company's common stock for the five trading days preceding the modification. As a result, the Company recorded a charge to common stockholders of \$1.2 million in the three-month period ending March 31, 2004. Accordingly, the carrying value of the Series B Preferred Stock was not accreted beyond the December 31, 2003 redemption price of \$12,480,000, which represented 120% of the total face value plus accrued but undeclared dividends as of that date.

As consideration for this agreement, and in full satisfaction of related penalties of \$375,000 incurred by the Company from January 2004 through the date of the modification, the Company paid to the holder \$200,000 on April 1, 2004, and issued the holder 500,000 unregistered shares of the Company's common stock with an approximate value of \$952,000 based on the average closing bid price of the Company's common stock for the five trading days preceding the modification. As a result, the Company recorded a charge to common stockholders of \$1.2 million in the three-month period ending March 31, 2004. The Company has not provided additional accretion to increase the carrying value of the Series B Preferred Stock to its redemption value based on the Company's assessment at March 31, 2004 that it is not probable that these securities will become redeemable.

The following is a summary of the rights of Series B Preferred Stock:

*Dividends:* The holders of the Series B Preferred are entitled to cumulative dividends. For the first two years that the Series B Preferred is outstanding, dividends accrue at 8% per annum and they are paid in kind by increasing the stated value of each share of Series B Preferred. After two years the dividends are payable in cash or in kind at our option, and the interest rate increases by 1% each calendar quarter up to a maximum of 14%.

*Conversion:* The holders of the Series B Preferred may convert their shares into common stock at any time at the conversion price, subject to adjustment for stock splits, stock dividends, recapitalizations and the like. We may convert the Series B Preferred into common stock beginning July 10, 2005 so long as: (i) our common stock is trading at \$4.65 or more for 20 consecutive trading days and (ii) a set of additional conditions are met including: the continued effectiveness of a registration statement for the common stock issuable upon conversion of the Series B Preferred and exercise of the warrants, continued listing of our common stock on the Nasdaq National Market or the Nasdaq SmallCap Market, compliance by us with procedures for delivery of share certificates upon the holders' prior requests to convert shares of Series B Preferred or exercise their warrants and other conditions, all of which must have been met during the 90 day period before conversion is sought. No holder of Series B Preferred may convert into our common stock or exercise warrants for our common stock if to do so would mean such holder would then own more than 4.99% of our outstanding common stock.

*Redemption:* We may redeem the Series B Preferred beginning July 10, 2005 for 120% of the purchase price for the Series B Preferred plus dividends paid in kind and any accrued but unpaid dividends, subject to compliance with conditions similar to the conversion conditions described above. The holders of the Series B Preferred may require us to redeem their shares upon a change of control (including a merger, acquisition or sale of all or substantially all of our assets) and if we default on certain obligations under the transaction documents (similar to the additional conversion conditions described above), at the greater of (i) 120% of the purchase price plus dividends paid in kind and any accrued but unpaid dividends or (ii) the closing bid price of the common stock issuable upon conversion of the Series B Preferred on the day before the announcement of the change of control or the default. We may also redeem the Series B Preferred at any time upon a change of control, at the greater of (i) 120% of the purchase price plus dividends paid in kind and any accrued but unpaid dividends and (ii) the closing bid price of the common stock issuable upon conversion of the Series B Preferred on the day before the announcement of the change of control, subject to compliance with conditions similar to the additional conversion conditions described above.

*Change of Control without Redemption:* Upon a change of control in which the holders of the Series B Preferred are not redeemed, the holders of the Series B Preferred are entitled to receive a security from the acquiring entity that is substantially similar to the Series B Preferred pursuant to a written agreement that is reasonably acceptable to the holders of the Series B Preferred.

*Voting Rights and Liquidation Preference:* The holders of the Series B Preferred are entitled to vote with our common stock holders on an as converted to common stock basis, provided that, no single holder of Series B Preferred may vote more than 4.99% of our outstanding shares. The approval of a majority of the Series B Preferred Stock is required before we may issue any capital stock that is senior or pari passu to the Series B Preferred or take other actions which adversely affect or impair the rights or relative priority of the holders of the Series B Preferred relative the holders of our common stock. The Series B Preferred is senior to all of our capital stock and it has a per share liquidation preference equal to the greater of (i) the initial purchase price plus any accrued and unpaid dividends and (ii) the value of the Series B Preferred Stock on an as converted to common stock basis based on the closing bid price of our common stock on the day prior to the liquidation.

## **11. SUBSEQUENT EVENTS**

On April 8, 2004, the Compensation Committee of the Board of Directors approved the grant of stock options to all employees of approximately 3,161,900 shares at an exercise price of \$1.00. 785,000 of these shares were granted to the Company's President, Chairman and Chief Executive Officer, Mark Hoffman, and a total of 800,000 additional shares were granted to other executive officers of the Company. Mr. Hoffman's shares are scheduled to vest over a period of two years from date of grant with an initial six month cliff, and the remainder of the options granted are scheduled to vest over a three-year period with an initial six month cliff. As a result of this grant, the Company will record a total deferred stock compensation expense of approximately \$2.2 million which will be amortized into expense over the vesting period of the options. In the event of termination of employment with the Company, amounts previously amortized for unvested and unexercised shares at the time of termination up to the amount previously expensed will be recorded as a reversal of stock compensation expense in that period.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION**

## **FORWARD-LOOKING STATEMENTS**

*This Form 10-Q contains forward-looking statements. These forward-looking statements include, but are not limited to, the following: management's belief that our available cash resources will be sufficient to finance our expected operating losses and working capital requirements through the 2004 calendar year; our expectations regarding our cash needs beyond 2004 and through June 30, 2005; our expectations that our dedicated sales efforts and product development efforts will increase license and services revenues relating to our Conductor platform and our SRM applications and that such increases will allow us to maintain our viability and assist in funding our operations through June 30, 2005; the expected decrease in cash expenditures as a result of, among other things, our expense reduction efforts; the expected growth of our business and related matters; the development and expected growth of a market for the Commerce One Conductor™ platform; the expectation that the Company will not sell and will retain the Supplier Relationship Management (SRM) assets; the benefits of our product offerings, including but not limited to statements regarding the ability of our products to provide efficiencies and cost savings associated with automating business processes; the ability of our Commerce One Conductor™ platform to integrate effectively with third party software applications; our ability to compete favorably with our competitors; the necessity of investing in product development for future success; the expectation that product development, sales, marketing, and administrative expenses will decrease in future periods; the potential benefits and/or gains associated with our restructuring efforts and divestitures; the potential benefits associated with outsourcing certain development work related to our products; the expected outcome of certain litigation and other disputes; the extent and timing of our expected restructuring charges; the expected impact of various accounting rules and pronouncements; whether we file additional patent applications; and the effect of interest rate, foreign currency exchange rate and equity price fluctuations. The words "believe," "expect," "intend," "plan," "project," "will" and similar words and phrases as they relate to Commerce One also identify forward-looking statements. Such statements reflect the current views and assumptions of Commerce One and are not guarantees of future performance. These statements are subject to various risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of the risk factors described in this Form 10-Q, including those under the heading "Risk Factors." Commerce One expressly disclaims any obligation to release publicly any updates or revisions to any forward-looking statements to reflect any changes in expectations, or any change in events or circumstances on which those statements are based, unless otherwise required by law.*

*Commerce One, Inc., together with Commerce One Operations, Inc. and their wholly-owned subsidiaries, are hereinafter sometimes referred to as "the Registrant," "the Company," "Commerce One," "we" and "us."*

## **OVERVIEW**

### **Background**

Commerce One is a technology company that specializes in software and services that allow companies to conduct business more efficiently through business process automation and web service solutions. The goal of our technology, products, and services is to make business processes and interactions more efficient and to automate business functions. From its inception, Commerce One has focused on providing advanced technologies that help global businesses collaborate with their partners, customers and suppliers over the Internet.

Commerce One's newest product offerings—the Commerce One Conductor™ platform and our existing and planned Composite Process Templates—represent our next generation of collaborative solutions designed to help our customers optimize their technology investments and improve the functionality of their existing software applications.

We were founded as Distrivision in 1994, changed our name to Commerce One in 1997, and re-incorporated in Delaware in 1999. On July 11, 2001, we reorganized into a holding company structure. As part of the reorganization, the stockholders of the "old" Commerce One (now our wholly-owned subsidiary Commerce One Operations, Inc.) became stockholders of the "new" Commerce One. Our worldwide headquarters are located at One Market, Steuart Tower, Suite 1300, San Francisco, CA 94105. We can be reached at 415.644.8700 and [info@commerceone.com](mailto:info@commerceone.com).

### **Source of Revenues**

We generate revenues primarily from software license fees and related service and support. License fees are generated from licensing our software solutions primarily to end-user organizations through our direct sales force, and, to a lesser extent, to certain third-party product distributors and resellers (primarily in international locations). Services revenues are generated from professional consulting, software maintenance, and revenue-sharing arrangements with customers.

Revenues from revenue-sharing arrangements have not been a significant portion of total services revenues to date and are not expected to be significant in the future.

The portion of our license and service revenues attributable to sales outside the United States continues to be a substantial portion of our overall revenues. In the first quarter of 2004, approximately 31% of our license and service revenues were derived from sales outside the United States, compared to 31% in the year ended December 31, 2003 and 35% in the year ended December 31, 2002.

In 2001, 2002 and 2003, we downsized our Global Services division, which provides professional services to third parties, through reductions in force and divestitures. Although consulting services remain a substantial portion of our revenues, these actions have contributed to a general decline in the overall revenues received from our consulting services.

## **SPECIFIC EVENTS IN THE QUARTER ENDED MARCH 31, 2004**

### **Renegotiation and Settlement of Certain Real Estate Obligations**

#### ***Pre-payment of Settlement Obligation***

As part of a June 2003 settlement with a former landlord, we agreed to make two cash payments of \$375,000 each in September 2004 and September 2005, respectively. These payments were included in our restructuring liability at December 31, 2003. The 2004 payment was secured by a lien against our accounts receivable until January 2005 (unless we defaulted on the 2004 payment in which case the lien would extend to both the 2004 and 2005 payments). In January 2004, we reached a further agreement with that landlord under which we paid \$500,000 in satisfaction of both the 2004 and 2005 cash payments. This pre-payment satisfies all of our remaining obligations to that landlord, although the underlying settlement agreement provides that the landlord will have a liquidated claim of \$6 million against us if—as the result of a bankruptcy of Commerce One or as the result of a fraudulent conveyance action—the landlord is disgorged of any payments it has received from us. That liquidated claim would be offset by any settlement payments that the landlord retains.

#### ***Austin Lease***

In January 2004, we signed an agreement with the landlord of the office space we occupy in Austin, Texas. Under the agreement, we reduced our monthly base rent obligation, retroactive to November 1, 2003, and also assigned to the landlord our sublease with a subtenant who had occupied some of our subleased space. In exchange, the landlord was permitted to draw down an existing letter of credit in the amount of approximately \$500,000 and reclaimed a significant portion of the space under lease. The net result of the transaction was to reduce our overall monthly lease obligation by approximately 40% through the term of the lease. However, the landlord also has the right to extend the lease for an additional 30 months upon its expiration in January 2006, subject to certain buyout rights of the Company.

### **Investment from BayStar Capital II, L.P.**

On July 10, 2003, we received a \$10 million investment from BayStar. Under the terms of our investment agreement with BayStar, we issued 100,000 shares of our Series B Preferred, and five-year warrants to purchase 2,209,945 shares of our common stock. The Series B Preferred is initially convertible into approximately 4,297,748 shares of our common stock at a conversion price of \$2.3268 per share. The exercise price for the warrants is \$2.715 per share.

Pursuant to the terms of the Series B Preferred Stock issued to BayStar, we may, upon the occurrence of certain events, be required to redeem all of the outstanding shares of Series B Preferred Stock. The events that could lead to redemption include failure to timely convert shares of Series B Preferred Stock into common stock when requested, to timely file, have declared effective and maintain the effectiveness of the registration statement on Form S-3 covering the resale of the common stock underlying the Series B Preferred Stock and the associated warrants or to maintain the listing of our common stock on the Nasdaq National Market or the Nasdaq SmallCap Market, or if we consummate a change of control (including a merger, acquisition or sale of all or substantially all of our assets) of Commerce One. As of the date of this Form 10-Q, the Form S-3 covering the resale of the common stock underlying the Series B Preferred Stock had not yet been declared effective by the SEC. Beginning in January 2004, we began incurring penalties of \$5,000 per day until the registration statement is declared effective. Under the initial agreement with Baystar, in the event that the Form S-3 was not declared effective on or prior to April 5, 2004, we could have been required to redeem the Series B Preferred Stock for approximately \$12 million or the fair market value of the common stock underlying the Series B Preferred Stock, whichever was greater, plus any accrued and unpaid dividends and other penalties which were estimated, as of December 31, 2003, to be approximately \$1.2 million on April 5, 2004. On March 14, 2004, we entered into a Consent and Amendment Agreement

with BayStar to amend certain provisions of our Registration Rights Agreement covering the registration of the Common Stock issuable upon conversion of our Series B Preferred Stock and the Common Stock issuable upon exercise of BayStar's warrants (collectively the "Registrable Securities"). Under this agreement, in exchange for a cash payment of \$200,000 made on April 1, 2004 and issuance of approximately 500,000 shares of our common stock with an approximate value of \$952,000 (based on the average closing bid price of our common stock for the five trading days preceding the issuance), BayStar agreed to extend the deadline by which our Registration Statement must be declared effective by the Securities and Exchange Commission by 90 days (to July 2, 2004). In addition, in exchange for such consideration, Baystar has agreed to waive the \$5,000 per day penalties accrued thus far and up to and including July 4, 2004. If the Registration Statement is not declared effective on or before July 4, 2004, BayStar would have the right to redeem the Series B Preferred Stock for a price equal to the greater of 120% of the original purchase price of \$10 million plus any accrued and unpaid dividends or the then current market value of the Series B Preferred Stock on an as-converted-to-Common Stock basis.

## **Significant Trends Affecting Our Business**

*Liquidity and Cash Flows from Operations.* We had cash and cash equivalents and short-term investments of approximately \$10.2 million at March 31, 2004, of which \$9.0 million was unrestricted cash and short-term investments that can be used to fund operations. In 2003, we used cash in operating activities of approximately \$91.2 million. We have taken significant steps to reduce our ongoing operating expenditures through personnel reductions, renegotiating and settling real estate obligations and other cost reduction measures. While these efforts have significantly reduced our operating expenditures, our operations are still drawing down our cash reserves. Our current cash position and expectations for the remainder of 2004 are discussed in more detail in the section below entitled "Liquidity and Capital Resources."

*New Product Introduction.* We launched the Commerce One Conductor<sup>TM</sup> platform, our new product, in March of 2003 and we are currently focused primarily on developing and selling this product line. Thus far, however, license revenue from sales of the Conductor platform has not been significant. Among the issues hampering our efforts to sell the Conductor platform are ongoing concerns of existing and potential customers regarding our viability, the lack of an established market for our new products, the length of sales cycles, particularly for a new and unproven technology, and a depressed technology market. Moreover, these same issues make it difficult to sell our SRM applications while we try to establish a market for the Conductor platform. We believe that these trends, particularly with respect to our SRM products, have affected us more than many of our competitors.

In addition, we do not expect that sales of the Commerce One Conductor<sup>TM</sup> platform will generate significant license revenue in the immediate future. In particular, in an effort to gain visibility of the product with our customers, we have provided the product to several "early adopter" customers under a program where the customer purchases the product at significantly reduced rates. We may continue to offer the product at reduced rates or pursuant to other similar programs in order to gain market acceptance. As a result, we do not anticipate that our average selling prices for our products will increase in the near future.

*Industry Dynamics—Decline in Enterprise Spending.* The enterprise software industry is characterized by several trends that may have a material impact on our strategic planning, results of operations and financial condition. One key trend has been the decline in spending on enterprise software as a result of the weakened global economy and uncertainty due to recent international events. This decline in enterprise spending has had a direct and significant adverse impact on our ability to generate license revenues from new and existing customers. The decline in spending has also been coupled with increased competition in our industry resulting in significant downward pricing pressure on our products. Taken together, these trends have resulted in a significant reduction in new sales and declining average selling prices for the products we do sell. In addition, we have only recently introduced our new product, and we expect that sales of such product will not generate significant license revenue in the immediate future. In particular, in an effort to gain visibility of the product with our customers, we have provided the product to several "early adopter" customers under a program where the customer purchases the product at significantly reduced rates. We may continue to offer the product at reduced rates or pursuant to other similar programs in order to gain market acceptance. As a result, we do not anticipate that our average selling prices for our products will increase in the near future.

*Utilization of Our SRM Assets.* In our most recent filings, we indicated that we were considering the sale of our SRM assets to generate additional necessary working capital. While there can be no assurance that we will not sell these assets in the future, we are not currently actively looking to sell our SRM assets. Currently, we plan to continue generating revenue through the direct license sales of our SRM products and related services in conjunction with our direct license sales efforts relating to the Conductor platform.

## **Recent Events**

### ***Stock Option Grant to Officers and Employees***

On April 8, 2004, the Compensation Committee of the Board of Directors approved the grant of stock options to all employees of approximately 3,161,900 shares at an exercise price of \$1.00. 785,000 of these shares were granted to the Company's President, Chairman and Chief Executive Officer, Mark Hoffman, and a total of 800,000 additional shares were granted to other executive officers of the Company. Beginning six months after the date of grant, Mr. Hoffman's shares are scheduled to vest over a period of two years, and the remainder of the options granted are scheduled to vest over a three-year period.

### ***Recent Personnel Changes***

On March 1, 2004, we announced several personnel changes at the Company. On February 16, 2004, Wain Beard, formerly a sales executive at Sybase, Inc., joined Commerce One as Senior Vice President of Worldwide Sales. Mr. Beard replaces Kip Quackenbush, who will assume the position of Senior Vice President, Channels. We also hired Ed Mueller as Senior Vice President of Marketing, effective March 1, 2004. Mr. Mueller replaces Narender Singh in this role, who has left Commerce One to pursue other opportunities. Prior to joining Commerce One, Mr. Mueller was an independent consultant and former executive and co-founder of ShortCycles, Inc. and db-Centric.

In addition, our Chief Financial Officer, Charles Boynton, recently notified us of his intention to resign his position to accept employment in Colorado. Currently, Mr. Boynton's expected departure date is approximately May 31, 2004. We have retained Todd Hagen, an Interim CFO, to replace Mr. Boynton. Our former Controller also departed the Company in the first quarter of 2004 to accept a position elsewhere and we have retained an Interim Controller to fill this role. We plan to conduct a search for permanent replacements for the CFO and Controller roles.

## ***CRITICAL ACCOUNTING POLICIES AND ESTIMATES***

The preparation of consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, we evaluate estimates, including those related to revenue recognition, software product returns, warranty obligations, uncollectible accounts receivable and long-lived assets. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about amount and timing of revenues and expenses, the carrying values of assets and the recorded amounts of liabilities that are not readily apparent from other sources. Actual results may differ from these estimates and such estimates may change if the underlying conditions or assumptions change.

We believe that these significant judgments affect the following critical accounting policies used in the preparation of our consolidated financial statements.

### **Revenue Recognition and Related Accounting Policies**

Our revenue recognition policies are consistent with Statement of Position 97-2 "Software Revenue Recognition," and Staff Accounting Bulletin No. 104, "Revenue Recognition".

Revenues from license agreements for our software products are recognized upon transfer of title and risk of loss which generally occurs upon shipment of the software if there is persuasive evidence of an arrangement, collection is probable and the fee is fixed or determinable. In the limited circumstances where our software is licensed to third parties through indirect sales channels (primarily in international locations), license fees are recognized as revenue, under the sell-through method, when the criteria described above have been met and the reseller has sold the software to an end user customer. While generally we do not license software under barter or concurrent arrangements, whenever software has been licensed under such arrangements, we have recognized revenue equal to the net monetary amounts to be received by us.

We assess whether fees are fixed or determinable when products or services have been delivered. Payment terms offered by us vary based on customer requirements and standard practice in the customer's country of domicile, and are typically within 90 days of delivery of the underlying products or services. Payment terms that extend beyond 90 days are not considered fixed or determinable, and are not recognized as revenue until the contractual payment due date, provided we then determine collection is probable and all other revenue recognition criteria have been met.

We reduce license revenue to reflect estimated product returns. While as a matter of contract and general practice, we do not accept the return of software products after the expiration of any acceptance periods, unforeseen contractual disputes with customers may require us to accept the return of a product. Management uses a percentage of trailing license revenue in order to calculate the required reserve balance. The appropriate percentage is determined by analyzing information pertaining to past customer issues or disputes for particular products. Our reserves have decreased significantly over the past twelve months due to lower license revenue. Should our actual product returns be greater than our estimates, or if we experience higher returns due to the introduction of our new Commerce One Conductor™ platform product, revisions to the product return allowance would be required which may lead to a decrease in license revenue.

Revenues from professional services contracts are generally recognized on a time and material basis. However, when we perform work on a fixed price basis, revenue is recognized on the percentage-of-completion method, with costs and estimated profits recorded as work is performed. We use labor hours as the input measure to determine progress under the percentage-of-completion-method. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in contract performance and estimated profitability, including final contract settlements, may result in revisions to costs and revenues, which are recognized in the period in which the revisions are determined.

If a customer transaction includes both software license and services elements, or the rights to multiple software products, the total arrangement fee is allocated to each of the elements using the residual method, under which revenue is allocated to undelivered elements based on vendor-specific objective evidence of the fair values of such undelivered elements and the residual amounts of revenue are allocated to the delivered elements.

Revenue is recognized using contract accounting for arrangements involving significant customization or modifications of the software or where professional services are considered necessary to the functionality of the software. Revenue from these software and services arrangements is recognized using the percentage-of-completion method by utilizing specific milestones in order to assess the progress achieved.

We recognize revenue from royalty agreements upon receipt of the royalty report when there is a signed agreement and collection is probable. Prepaid royalties are recorded as deferred revenue until the royalty report is received. For limited term fixed fee royalty agreements, we recognize the total fee ratably over the term of the royalty agreement.

Software maintenance revenues, subscription fees and hosting fees are recognized ratably over the term of the related contract, typically one year, upon cash receipt.

Subscription fees and hosting fees have not been significant and are not expected to be significant in the future. Revenues related to revenue sharing are recognized as earned based on customer transactions. Revenues related to hosting fees generally are recognized ratably over the term of the related contracts, typically one year. In January 2003, we divested to eScout LLC our CommerceOne.net division, which offered hosting, software subscription services, transaction-based marketplace services and content services. During 2002, we recognized service revenues totaling approximately \$11.8 million from CommerceOne.net related services. During 2003, we recognized a total of approximately \$3.2 million in services revenue from CommerceOne.net related services. Due to this divestiture, we will no longer offer these services. As a result of this divestiture, we received no transaction fees in 2003 or in the first quarter of 2004 and will no longer receive these fees in the future. In addition, our hosting revenue has declined substantially and will be limited solely to the recognition of revenue that previously had been deferred.

Deferred revenue consists of prepaid licenses fees as well as prepaid fees for royalties, services and maintenance and support agreements.

### **Allowance for Doubtful Accounts**

We maintain accounts receivable allowances for doubtful accounts, estimated product and service returns and for certain performance related claims.

Our allowance for doubtful accounts reflects our estimate of losses resulting from the inability of our customers to make required payments based on our analysis of the current credit worthiness of the customer, prior payment history and the age of the receivables. We will periodically assess whether our actual collection results differ substantially from our estimates and adjust our assumptions if necessary. Periodic provisions to our allowance for doubtful accounts are recorded as a component of our general and administrative expense. We write-off specific customer accounts receivable balances against the allowance after our normal collection efforts have been unsuccessful.

During 2003 and the first quarter of 2004, we decreased the balance of our allowance for doubtful accounts primarily due to a decrease in our accounts receivable balance related to an overall revenue decline and collection on or write-off of accounts that were previously reserved. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make such payments, increases in the allowance may be required.

Our allowance for product and services revenue returns was established through reductions in license and service revenues and relates to performance issues raised by certain customers with outstanding receivable balances. We believe the rapid deterioration in economic circumstances, especially during 2001, was a significant factor for these claims. We write-off specific customer accounts receivable balances against the allowance after our efforts to resolve the performance issues have been unsuccessful, or upon determination that the receivable balance is otherwise uncollectible. The performance matters raised in 2001 were substantially resolved in 2002.

Our allowance for license performance claims was established in 2001 by charges to cost of license fees as a result of performance issues raised by certain license customers with outstanding receivable balances. This allowance has been reflected as a reduction to our accounts receivable balance since it relates to certain outstanding receivable balances. The performance matters raised in 2001 were resolved and at March 31, 2004, no allowance for performance claims was deemed necessary.

### **Long-lived Assets and Goodwill**

In accordance with the provisions of Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets," we periodically assess the carrying value of our long-lived assets including property and equipment, our Technology Agreement with Covisint and other identified intangible assets for impairment. An impairment assessment is performed whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Impairment indicators include, but are not limited to, our net book value as compared to market capitalization, significant negative industry and economic trends, a significant decline in our stock price for a sustained period and significant under performance relative to historical and projected future operating results. In assessing the recoverability of the carrying value of intangible assets, we must make assumptions regarding the estimated future cash flows attributable to these assets. In addition, we must make assumptions regarding discount rates to determine the fair value of the respective assets. We have typically relied on valuation consultants to assist in the analysis of these factors. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for these assets not previously recorded which could have a significant impact on our operating results. In 2002, we recorded impairment charges of \$394.0 million related to property and equipment, goodwill and other intangible assets.

During the quarter ended September 30, 2003, we identified indicators of possible impairment relating to the Technology Agreement with Covisint. The primary impairment indicator was the recent dispute and related negotiation with Covisint regarding Covisint's revenue sharing obligations. Because the projected undiscounted cash flows were below the current carrying value of the intangible asset, an impairment existed and we therefore performed a discounted cash flow analysis to value the asset. Based upon our analysis, we believe that the Technology Agreement with Covisint was valued at \$6 million as of the quarter ended September 30, 2003. As a result, in the quarter ended September 30, 2003, we recorded an impairment charge of \$8.4 million related to our Technology Agreement with Covisint. The presence of indicators of impairment in future periods may result in further impairment of our intangible assets. On December 30, 2003, we entered into a settlement agreement with Covisint pursuant to which Covisint paid us \$4,650,000. As part of the agreement, the parties agreed to resolve the arbitration and a related state court action that had been pending between the parties, and we granted a fully paid software license to Covisint for certain Commerce One software that Covisint has used in its operations. We previously had licensed that software to Covisint under the Technology Agreement, which the parties agreed to terminate under certain conditions as part of the settlement. Covisint paid us in full by January 2, 2004. All litigation between the parties has now been permanently dismissed, and the Technology Agreement that previously governed the relationship between us and Covisint has terminated. As a result of the settlement, we recognized a charge to "Cost of license fees" of \$6.0 million in the fourth quarter of 2003 due to the write down of the intangible asset related to the Technology Agreement.

### **Stock-based Compensation**

We generally have three categories of employee stock-based awards: restricted stock, stock options and a stock purchase plan. We account for employee stock options using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB 25") and have adopted the disclosure-only alternative of SFAS No. 123, "Accounting for Stock-Based Compensation" as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." Under the intrinsic value method, the Company has only recorded stock-based compensation resulting from restricted stock issued and options assumed in various prior period



acquisitions. In September 2003, the Board of Directors approved the acceleration of vesting of certain "out-of-the-money" employee stock options related to the prior acquisitions of Exterprise, Mergent and AppNet. As a result of the full vesting of these stock options, we do not expect to incur any future additional charge to stock compensation expense for deferred compensation related to these prior acquisitions.

Restricted stock is measured at fair value on the date of grant based on the number of shares granted and the quoted price of the Company's common stock. Such value is recognized as an expense ratably over the corresponding employee service period. To the extent restricted stock or restricted stock units are forfeited prior to vesting, the corresponding previously recognized expense is reversed as an offset to "Stock-based compensation."

## **Restructuring Accrual**

We have undergone multiple restructuring transactions during 2001, 2002 and 2003. In accordance with EITF 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)", the cost associated with transactions initiated in 2001 and 2002 have been charged to restructuring expense in the period in which we committed to the restructuring plan. The charges relating to the consolidation and closing of facilities and asset dispositions required significant estimates to determine the amount of future payments to be accrued as a part of the restructuring activity. A change in the circumstances related to the plan for closure of the facilities could result in additional charges or the reversal of prior charges taken.

In June 2002, the Financial Accounting Standards Board issued SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF Issue No. 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, not at the date of an entity's commitment to an exit plan, as required under EITF 94-3. The provisions of SFAS 146 were effective for exit or disposal activities initiated after December 31, 2002. During 2003, we recorded restructuring costs of \$20.7 million under the provisions of SFAS 146. The adoption of SFAS 146 may affect the timing of recognizing future restructuring costs and the amounts recognized under such costs.

Our restructuring charges and accrual have been based on our estimates of future headcount and facility requirements. If we determine that our actual requirements are less than our estimated requirements, we may be required to record additional charges to further reduce our headcount and to close additional facilities. In addition, our restructuring accrual is based on other estimates including estimates of future sublease income and estimates of benefits to be paid to terminated employees. At March 31, 2004, our restructuring liabilities were primarily comprised of estimated payments to terminated employees. We do not expect actual payments to differ significantly from our estimates.

## **RELATIONSHIP WITH SAP**

### **Relationship with SAP AG**

#### ***Termination of Commercial Relationship***

We entered into a strategic relationship with SAP in 2000 to jointly develop, market and sell the MarketSet suite of applications and the Enterprise Buyer procurement applications. This agreement provided that either party licensing the jointly developed products to its customers would owe a royalty to the other party. These products were primarily targeted at electronic marketplace customers. Historically, SAP was instrumental in assisting us with selling the jointly developed products to SAP's customer base. From 2000 to 2002, SAP accounted for a significant portion of our license revenue. However, these royalty payments declined in the past two years with the decline of the market for electronic marketplace solutions. In the first quarter of 2004 and 2003, SAP license revenues were approximately \$0 and \$0.4 million, respectively.

Over time, the relationship with SAP has changed and each company has phased out the jointly developed Enterprise Buyer procurement products and replaced such products with its own successor procurement products. In addition, the market for the Marketset suite of products has declined substantially over the past two years with the decline in the electronic marketplace sector. In November 2003, SAP and Commerce One terminated the commercial relationship. As a result, we received only \$0.4 million in license revenue from SAP in 2003, we received no license revenue in the first quarter of 2004 and do not expect to receive any license revenue in the remainder of 2004 or thereafter.

#### ***Equity Relationship***

At the time we entered into the strategic alliance agreement with SAP in 2000, we sold 505,955 shares of our common stock to SAP for an aggregate purchase price of approximately \$250 million.

Subsequently, in 2001, we sold an additional 4,748,477 shares of our common stock to SAP for an aggregate purchase price of approximately \$225 million.

In connection with our issuance of common stock to SAP, we entered into various agreements that restrict SAP's ability to acquire more than 23% of our outstanding common stock or otherwise attempt to acquire control of Commerce One, limit its transfer of the shares of common stock that it purchased from us and, in very limited ways, affect SAP's ability to vote its shares of our common stock. We also granted SAP certain rights to require us to register the resale of its shares of our common stock, certain pro rata rights to acquire additional shares of our common stock and the right to have a designee appointed to our board of directors or to send an observer to our board of directors meetings. As of March 31, 2004, SAP has not exercised its right to have such a designee appointed, but has exercised its right to send an observer to our board of directors meetings.

Certain of the transfer restrictions imposed upon SAP's ability to sell our common stock expired upon the termination of the SAP relationship in November 2003 and most of the remaining transfer restrictions will terminate on June 28, 2004. The standstill restrictions imposed upon SAP, as well as their pro rata rights, will also terminate on June 28, 2004.

As of March 31, 2004, through its purchases from us and on the open market, we believe that SAP beneficially owned approximately 20% of our outstanding common stock.

## **LIQUIDITY AND CAPITAL RESOURCES**

We had cash and cash equivalents and investments of approximately \$10.2 million at March 31, 2004 compared to approximately \$74.6 million at March 31, 2003. The amounts as of March 31, 2004, included approximately \$1.2 million that collateralized certain of our obligations related to operating lease agreements for computer equipment and office facilities and potential workers compensation claims. As of March 31, 2004, we had \$9.0 million in unrestricted cash and short-term investments that could be used to fund our operations.

### **Net Cash Used in Operating Activities**

Net cash used in operating activities totaled approximately \$3.2 million for the three months ended March 31, 2004 compared to approximately \$43.3 million for the three months ended March 31, 2003. Cash used in operating activities for the period ended March 31, 2004 resulted primarily from the net loss, excluding non-cash charges for amortization and depreciation, an approximate \$1.3 million decrease due to deferred revenue and an approximate \$1.8 million decrease due to other liabilities partially offset by an approximate \$3.9 million increase due to collections on receivables and an approximate \$2.3 million non-cash increase due to an adjustment to the mark-to-market valuation of the warrant liability. Net cash used in operating activities for the three months ended March 31, 2003 resulted primarily from the net loss, adjusted for non-cash items including depreciation and amortization, and an approximate \$5.0 million decrease in restricted investments, an approximate \$2.9 million decrease in prepaid expenses and other current assets, an approximate \$4.6 million decrease in other liabilities and an approximate \$2.0 million decrease in deferred revenue.

### **Net Cash Provided by Investing Activities**

Net cash provided by investing activities totaled approximately \$1.4 million for the three months ended March 31, 2004. Cash provided by investing activities in the current period related primarily to the maturity of short-term investments of \$1.6 million, offset by the purchase of short-term investments of approximately \$0.2 million. Cash provided by investing activities was \$5.7 million in the three months ended March 31, 2003 and related to the maturity of short-term investments of \$5.7 million.

### **Net Cash Provided by Financing Activities**

Net cash provided by financing activities totaled approximately \$3.9 million for the three months ended March 31, 2004. No cash was used or provided by financing activities for the three months ended March 31, 2003. The net cash provided by financing activities in the three months ended March 31, 2004 resulted from proceeds of approximately \$3.8 million due from ComVest in connection with the debt financing we completed with them as of December 31, 2003.

## Contractual Obligations

The following summarizes our contractual obligations as of March 31, 2004, and the effects such obligations are expected to have on our liquidity and cash flows in certain future periods after March 31, 2004 (in thousands):

	<b>Total</b>	<b>Less than one year</b>	<b>1 to 3 years</b>	<b>4 to 5 years</b>	<b>5 years and thereafter</b>
Non-cancelable operating lease obligations.....	\$ 5,613	\$ 1,247	\$ 4,179	\$ 187	\$ --
Accrued restructuring costs.....	763	763	--	--	--
PeopleSoft note payable.....	2,039	2,039	--	--	--
ComVest/DCC notes payable.....	5,507	5,507	--	--	--
Warrant liability.....	2,682	--	--	--	2,682
Total.....	<u>\$ 16,604</u>	<u>\$ 9,556</u>	<u>\$ 4,179</u>	<u>\$ 187</u>	<u>\$ 2,682</u>

The above table does not include the redemption value of approximately \$12.5 million of the Series B Preferred Stock issued to BayStar in the event that the underlying common shares are not registered by a certain date (see discussion of BayStar redemption in "Sources of Liquidity and Capital" section below).

## Real Estate Obligations

As of March 31, 2004, Commerce One leased office space in four locations throughout the United States, which represent the majority of our real estate obligations. We have subleased, reduced or otherwise renegotiated a significant portion of the long-term real estate obligations for our surplus office space in the United States, but some of our existing space remains underutilized. In addition, we lease several smaller and/or temporary locations in Europe to support our international operations.

The Company's total non-cancelable operating lease obligations as of March 31, 2004 was \$5.6 million. We have no significant capital commitments or obligations other than those described in the analysis above. We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor have we any commitment or intent to provide additional funding to any such entity.

## Sources of Liquidity and Capital

We have historically satisfied our cash requirements primarily through the issuances of equity securities and, to a significantly lesser extent, through debt financing.

On December 31, 2003, we issued secured promissory notes in the aggregate principal amount of \$5.0 million and warrants to purchase our common stock to ComVest and DCC Ventures (collectively "ComVest") for an aggregate purchase price of \$5.0 million. Of this amount, \$1.0 million was received on December 31, 2003. The remaining \$4.0 million, recorded at December 31, 2003 as a short-term note receivable, was received on January 3, 2004.

On December 30, 2003, we entered into a Settlement Agreement with Covisint, LLC (Covisint) pursuant to which Covisint paid us \$4,650,000. As part of the agreement, the parties resolved an arbitration and a separate Michigan state court action that had been pending between the parties, and we granted a fully paid software license to Covisint for certain Commerce One software that Covisint has used in its operations. \$750,000 of the \$4,650,000 payment from Covisint was received on December 31, 2003 and the remainder (approximately \$3,900,000) was received on January 2, 2004.

We had cash and cash equivalents and short-term investments of approximately \$10.2 million at March 31, 2004, of which \$9.0 million was unrestricted cash and short-term investments that can be used to fund operations. In the first quarter of 2004, our net total restricted cash decreased by approximately \$1.9 million primarily due to a purchase of leased equipment with a lessor whereby certificates of deposit totaling approximately \$1.6 million were released by the lessor in

exchange for the equipment. Our net total unrestricted cash increased by approximately \$2.0 million. This cash was used primarily to fund our operations. In addition, we received approximately \$4.6 million in January from the settlement with Covisint described above. We have taken significant steps to reduce our ongoing operating expenditures, including a personnel reduction in October 2003 that reduced our headcount to approximately 101 employees at March 31, 2004, and multiple real estate settlements. While these efforts have significantly reduced our operating expenditures, our operations are still drawing down our cash reserves.

Our continued viability is in part dependent on our ability to generate revenues through sales of Commerce One Conductor platform and composite process management solutions and on our ability to generate increasing revenues through sales of SRM products and services.

We are building the market opportunity for our Commerce One Conductor platform. The Conductor platform was released in early 2003 and sales of the platform thus far have not been significant. Although there can be no assurance that such efforts will increase our Conductor revenues, we have hired a sales force focused on direct license sales of the Conductor platform and related composite process management applications and we released a new version of the Conductor platform with enhanced functionality in October 2003.

In our most recent filings, we indicated that we were considering the sale of our Supplier Relationship Management (SRM) assets to generate additional necessary working capital. While there can be no assurance that we will not sell these assets in the future, we are not currently actively looking to sell our SRM assets. Currently, we plan to continue generating revenue through the direct license sales of SRM products and related services in conjunction with our direct license sales efforts relating to the Conductor platform. SRM revenues have been declining during the past 12 months. Although there can be no assurance that such efforts will increase our SRM revenues, we plan to dedicate sales efforts focused on our SRM applications and we are creating a product development plan to enhance the SRM products.

Based upon our current plans and expectations, we believe that we will have sufficient cash to fund our operations through the remainder of 2004. However, plans and expectations are inherently uncertain and if our revenues do not meet our expectations or we encounter expenses or cash outlays that are greater than anticipated, we may not have sufficient cash to sustain our operations through 2004. In addition, we believe that we will need to increase our revenues and/or raise additional capital to meet our liquidity and capital needs beyond 2004. We may seek to raise additional capital through, among other things, potential asset sales, additional equity or debt financings, or some combination of these. As announced previously, the Company has retained Broadview International LLC to evaluate various strategic alternatives. Previously, we announced that we were considering the sale of our Supplier Relationship Management (SRM) applications. Although no assurance can be provided that such sale will not occur and plans and expectations are inherently uncertain, the Company is not currently actively pursuing the sale of such applications. Our \$5.0 million promissory notes with ComVest and DCC Ventures (the "ComVest Notes") are secured by, among other things, the SRM applications and a \$2.0 million note from eScout LLC issued to us in conjunction with the sale of our CommerceOne.net assets to eScout in January of 2003. We will need to repay the ComVest Notes at their maturity date in March 2005. The eScout note is due to be paid to us in January 2005 and the proceeds will need to be used for repayment to ComVest at such time pursuant to the terms of our agreement with ComVest, if the ComVest Notes have not yet been repaid. In addition, pursuant to a real estate settlement we entered into with PeopleSoft, Inc., our former landlord in Pleasanton, California, we owe PeopleSoft approximately \$2.1 million on February 22, 2005 ("PeopleSoft Note"). As a result of these debt obligations, we believe that we will need to raise up to an additional \$7.0 million in order to meet our \$7.1 million repayment obligations on the PeopleSoft Note and the ComVest Notes, which are due in February 2005 and March 2005, respectively. We believe that these amounts, in conjunction with our expected revenues, will provide us with sufficient cash to fund our operations through June 30, 2005. If actual revenues fall short of our expectations, we believe that we will need to raise approximately an additional \$2.0-5.0 million to fund our operations through June 30, 2005. We cannot currently estimate our specific financing needs beyond June 30, 2005, but may need to raise additional financing at that time.

The current unfavorable market for equity or debt financing makes it increasingly difficult to raise additional funding. In addition, the rights of our Series B Preferred Stock holder, BayStar, or our secured lenders, ComVest and DCC Ventures, may discourage other potential investors and diminish our ability to obtain additional financing. If our revenues do not meet our expectations, we are unable to obtain additional financing, or we encounter expenses or cash outlays that are larger than expected, our remaining cash reserves may not be sufficient to sustain our operations through 2004 or beyond. In addition, our Series B Preferred Stock will become redeemable on July 5, 2004 unless we are able to have declared effective and maintain the effectiveness of a registration statement covering the resale of underlying common stock by July 2, 2004. If BayStar chooses to exercise its redemption right at that time, we would not have sufficient cash to cover such redemption and our ability to fund our operations would be severely damaged. If we do not have sufficient cash to fund our operations, we will need to pursue other alternatives such as the sale of some or all of our assets, dramatically reducing or discontinuing

some or all of our operations or filing for bankruptcy protection. If we do file for bankruptcy protection, there can be no assurance that we can effectively reorganize under Chapter 11 of the Bankruptcy Code or that we would be able to earn sufficient proceeds from a liquidation under Chapter 7 of the Bankruptcy Code to pay all of our creditors or provide any proceeds to our stockholders.

The forecasts of the periods of time through which our financial resources will be adequate to support our operations and all related statements are forward-looking statements that involves risks and uncertainties, and actual results could vary materially as a result of the factors described in this paragraph and in the section entitled "Risk Factors."

## **RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2004 AND 2003**

### **Revenue**

Total revenues for the three months ended March 31, 2004 decreased to approximately \$2.7 million compared to \$13.1 million for the three months ended March 31, 2003. For the three months ended March 31, 2004, one customer, Exostar, accounted for more than 10% of our revenue at 31%. For the three months ended March 31, 2003, other than revenues earned through transactions with SAP, which accounted for approximately 12% of our revenue, one other customer, Exostar, accounted for more than 10% of our revenue at 16%.

#### *License Revenue*

License revenues for the three months ended March 31, 2004 decreased to approximately \$0.3 million compared to \$2.2 million for the three months ended March 31, 2003. In 2004, a significant portion of the \$2.0 million decrease in license revenue was due to a significant drop in SAP license royalties. SAP royalties in first quarter of 2004 were \$0, a decrease of \$0.4 million from the same period in 2003. The remaining \$1.6 million reduction in license revenue is due to a decrease in the number of customers. The average license revenue per customer was \$121,000 in 2004, a 3% decrease from the \$125,000 in 2003. Excluding SAP, we recognized license revenues relating to 2 specific customers in 2004, an 85% decrease from the same period in the prior year. In the first quarter of 2004, the decrease in license revenues relative to prior years primarily resulted from the change in focus from our previous generation of products; a significant slowdown in technology spending coupled with the continued general economic downturn; and intense competition in the market for packaged SRM applications, to which we were a relatively new entrant in 2001 and 2002. In November 2003, we terminated our relationship with SAP and as a result, we do not expect to receive any revenues from SAP for technical support and maintenance in the remainder of 2004 or thereafter.

Direct license sales of our SRM applications in both object code and source code form represented the substantial majority of our license revenues in 2003 and represented all of our license revenues in the first quarter of 2004. We introduced our Commerce One Conductor™ platform in 2003, and license fees from this platform have not represented a substantial portion of our license revenues to date. Going forward, we plan to focus our sales efforts on our Commerce One Conductor platform as well as our SRM applications.

#### *Services Revenue*

Services revenues for the three months ended March 31, 2004 decreased to \$2.4 million compared to \$10.9 million in the same period in the prior year. The percentage of our revenues attributable to professional services in the first quarter of 2004 increased again as compared to the same period in 2003, and professional services remained the largest portion of our overall revenue. The services revenue decrease in the first quarter of 2004 as compared to the same period in the prior year resulted primarily from the downsizing of the Global services division through reductions in force and divestitures of various Global Services divisions amounting to approximately \$2.8 million, an approximate \$0.6 million reduction in the amounts received from various historical revenue-sharing arrangements (primarily Covisint, with whom we were engaged in a payment dispute throughout 2003), continued termination and reduction of support and maintenance agreements by existing customers amounting to approximately \$2.2 million, particularly our electronic marketplace customers, and an approximate \$2.9 million decrease in revenues from maintenance, hosting services and other revenue services commensurate with the overall decline in license revenues. We expect that services revenues will decrease in 2004 as compared to 2003 primarily due to the decrease in the number of employees in our professional service division. Our services revenues may also decline if we are unable to maintain our prices and utilization rates. Our new Commerce One Conductor™ platform product was released for general availability in March 2003, and has not generated, nor do we expect it to generate, significant services engagements or maintenance revenues in the short term until the product is more broadly used by our customers.

In January 2003, we closed the sale of CommerceOne.net, our marketplace services business, consisting of auction services, subscription services, content services and hosting services, to eScout. During 2003, we recognized a total of approximately \$3.2 million in services revenue from CommerceOne.net related services. Subsequent to this sale, Commerce One no longer offers these services and therefore did not receive any additional revenues related to these services in the first quarter of 2004 and will not in the future.

Payments received from our strategic alliance with SAP constituted a substantial portion of our total revenues during the three months ended March 31, 2003. Total revenues received from SAP were approximately \$0 and \$1.5 million for the three months ended March 31, 2004 and 2003, respectively, of which license revenues were approximately \$0 and \$0.4 million. Due to the termination of our relationship with SAP, we do not expect to receive revenues from SAP in the remainder of 2004 or thereafter.

### **Cost of Revenues**

Cost of revenues consisting of cost of services and cost of licenses were approximately \$1.7 million, or 52% of total revenues, in the three months ended March 31, 2004; and \$9.2 million, or 70% of total revenues, in the three months ended March 31, 2003.

### ***Cost of License Fees***

Cost of license fees were \$0.3 million in the three months ended March 31, 2004, compared to \$0.3 million in the three months ended March 31, 2003. In the first quarter of 2004, cost of license fees was composed entirely of third party software royalties of approximately \$0.3 million. This compares to cost of license fees in the first quarter of 2003 of a negative \$0.2 million due to reserve adjustments for that period offset by an approximate \$0.5 million in amortization related to the Technology Agreement with Covisint.

### ***Cost of Services***

Cost of services, which primarily consists of consulting, personnel and related cost, software maintenance and training costs, was \$1.4 million for the three months ended March 31, 2004 and \$8.9 million for the three months ended March 31, 2003. The decrease in cost of services in the first quarter of 2004 resulted primarily from an approximate \$4.2 million decrease in salaries and wages resulting from the downsizing of the Global Services division through reductions in force and divestitures of certain business segments, an approximate \$0.5 million decrease in depreciation expense, an approximate \$0.9 million decrease in outside consulting expenses, an approximate \$0.5 million decrease in IT spending, an approximate \$0.3 million decrease in insurance, an approximate \$0.8 million decrease in rent and a decrease of approximately \$0.3 million of other expenses, primarily reduced facilities and associated costs.

### **Sales and Marketing Expenses**

Sales and marketing expenses consist primarily of personnel and related cost and commissions, and the costs of seminars, promotional materials, trade shows and other sales and marketing programs. Sales and marketing expenses were approximately \$1.2 million for the three months ended March 31, 2004 compared to approximately \$7.9 million for the three months ended March 31, 2003. The decrease in 2004 was primarily attributable to an approximate \$4.0 million decrease in salaries and wages due to an overall decrease in the average number of sales and marketing personnel during the year, an approximate \$0.3 million decrease in depreciation expense, an approximate \$0.4 million decrease in IT spending, an approximate \$0.5 million decrease in rent, an approximate \$0.2 million decrease in insurance, and an approximate \$1.1 million decrease in outside services and consulting expenses and an approximate \$0.2 million decrease in other charges, primarily rent and telephone charges as a result of the reduced workforce.

### **Product Development Expenses**

Product development expenses consist primarily of personnel and related costs associated with our product development efforts. Product development expenses were approximately \$1.9 million for the three months ended March 31, 2004 compared to approximately \$11.4 million for the three months ended March 31, 2003. In 2004, these expenses related primarily to the development of our new Commerce One Conductor™ platform product, as well as certain expenses pertaining to ongoing development of our SRM applications. The decrease in 2004 in product development expenses was primarily attributable to an approximate \$7.3 million decrease in salaries and wages due to an overall decrease in the average number of product development personnel employed during the year, an approximate \$1.0 million decrease in rent, an

approximate \$0.5 million decrease in IT spending, an approximate \$0.6 million decrease in depreciation expense and a decrease of approximately \$0.1 million of other charges primarily consisting of travel-related expenses.

In January 2003, we entered into an outsourcing arrangement with Satyam Computer Services Limited. Pursuant to this agreement, Satyam provides certain support, maintenance and product development services with respect to our SRM applications, including our Commerce One Buy and Commerce One Source products. Despite additional costs associated with our outsourcing agreement with Satyam, we expect total product development expenses to decrease in 2004 due to the significant reduction in the number of employees engaged in product development.

### **General and Administrative Expenses**

General and administrative expenses consist primarily of employee salaries and related expenses for executive, administrative and finance personnel. General and administrative expenses were approximately \$2.8 million for the three months ended March 31, 2004 compared to approximately \$2.4 million for the three months ended March 31, 2003. The increase in the first quarter of 2004 was primarily attributable to a decrease of approximately \$1.6 million in salary and wages resulting from an overall decrease in the average number of general and administrative personnel employed during the quarter and an approximate \$0.5 million in other savings, offset by an approximate \$0.4 million increase in consultant expenses, and an approximate \$1.3 million increase in IT expenses associated with the IT allocation based on a pro rata allocation of headcount to each department. In addition, there was an approximate \$0.8 million increase in bad debt expense which consisted of a negative balance of \$0.5 million in the first quarter of 2004 as a result of customer collections and lower sales, compared to a negative balance of \$1.3 million in the first quarter of 2003 due to a reversal of reserves for bad debts associated with customer collections and lower sales.

### **Stock Compensation**

Stock compensation expenses result from the grant of stock options, grant of restricted common stock and sales of stock to employees at exercise or sales prices below the deemed fair market value of our common stock. Stock compensation expense was \$0 in the first quarter of 2004 compared to approximately \$1.0 million in the first quarter of 2003.

Due to the grant to employees and officers on April 8, 2004 of approximately 3,161,900 stock options at an exercise price of \$1.00, we expect that we will incur a total stock compensation expense of approximately \$2.2 million over the vesting period. As employees terminate their employment with the Company, the value of their unvested shares at time of termination up to the amount previously expensed will be recorded as a reversal of stock compensation expense in that period. (See "Recent Events" above for a more detailed description).

### **Restructuring Charges**

#### **2003 Restructuring Plans**

The following tables summarize the activity related to restructuring plans initiated in 2003, and accounted for in accordance with FAS 146, for the three months ended March 31, 2003 and 2004 (in thousands):

#### *2003 Restructuring Activities*

	Accrued restruc- turing costs at December 31, 2002	Amounts charged to restruc- turing costs and other	Amounts paid or written off	Accrued restruc- turing costs at March 31, 2003
January 2003 Plan:				
Lease cancellations and commitments.....	\$ --	\$ 137	\$ --	\$ 137
Termination payments to employees and related costs.....	--	10,085	(5,616)	4,469
Write-off on disposal of assets and related costs.....	--	81	(81)	--
Total restructuring accrual and other.....	\$ --	\$ 10,303	\$ (5,697)	\$ 4,606

#### January 2003 Plan

In January 2003, management approved and began to implement a restructuring plan aimed at further reducing its operating expenses while continuing to align Commerce One's resources around its core product initiatives. This first quarter activity was intended to reduce the Company's headcount by approximately 430 employees and payroll related expenses by \$53 million annually. In the first quarter of 2003, we recorded approximately \$10.3 million to restructuring charges, primarily in relation to severance pay, continued benefits, and outplacement services. Of this accrued amount, approximately \$5.7 million was paid during the quarter ended March 31, 2003.

#### *2004 Restructuring Activities*

	Accrued restruc- turing costs at December 31, 2003	Amounts charged to restruc- turing costs and other	Amounts reversed	Amounts paid or written off	Accrued restruc- turing costs at March 31, 2004
January 2003 Plan:					
Lease cancellations and commitments.....	\$ 814	\$ --	\$ (250)	\$ (564)	\$ --
	814	--	(250)	(564)	--
October 2003 Plan:					
Termination payments to employees and related costs.....	1,412	--	--	(831)	581
Write-off on disposal of assets and related costs.....	204	--	--	(123)	81
	1,616	--	--	(954)	662
Total restructuring accrual and other.....	\$ 2,430	\$ --	\$ (250)	\$ (1,518)	\$ 662

#### January 2003 Plan

In April 2003, in connection with the headcount reductions made under the January 2003 Plan, we entered into an agreement to terminate our Cambridge, Massachusetts office lease agreement by paying \$750,000 cash, and agreeing to make two additional cash payments of \$375,000 each to be paid in September 2004 and September 2005, respectively. As a result, we recorded a \$1.5 million charge to restructuring and established a restructuring liability for the additional cash payments. In January 2004, we settled the two future payments of \$375,000 for one payment of \$500,000 payable in January 2004. This \$500,000 final payment was made to the landlord in January 2004 and the net savings of this renegotiation of \$250,000



was recorded as a reversal to restructure expense in the first quarter of 2004. In addition, a final payment of approximately \$64,000 was paid during the three months ended March 31, 2004 on another existing lease.

As a result of final payments made to landlords in the first quarter of 2004, all real estate activities and payments under this plan were completed by March 31, 2004.

#### October 2003 Plan

In October 2003, we continued to rationalize our operating expenses by implementing additional restructuring initiatives. The initiatives mainly focused on reducing worldwide headcount to 116 employees by the end of the fourth quarter of 2003 and to reduce payroll related expenses by \$10 million annually. The remaining employee termination accrual of \$1.4 million as of December 31, 2003 primarily related to payments to be made in 2004 in accordance with applicable French laws governing termination payments to employees. During the quarter ended March 31, 2004, we paid approximately \$0.8 million to terminated French employees in the form of salary and severance pay. In addition, approximately \$0.1 million was paid in connection with the disposal of assets associated with the French subsidiary.

We expect that the remaining liability of \$0.7 million at March 31, 2004 for the October 2003 Plan will be paid in full by December 31, 2004.

#### **2002 Restructuring Plans**

In 2002, we implemented multiple restructuring plans (the "Plans") aimed at significantly reducing our operating expenses while realigning our resources around our core product initiatives. The Plans included costs such as separation pay, outplacement services and benefit continuation, as well as the termination of certain office leases, the divestiture of certain parts of Commerce One's Global Services division, the consolidation or closure of certain facilities and the write-down of the carrying value of computers and equipment used by employees who were terminated.

The following tables summarize the activity related to the restructuring plans initiated prior to January 1, 2003, and accounted for in accordance with EITF 94-3, for the three months ended March 31, 2003 and 2004 (in thousands):

#### *2003 Restructuring Activities*

	Accrued restruc- turing costs at December 31, 2002	Amounts charged to restruc- turing costs and other	Amounts reversed	Amounts paid or written off	Accrued restruc- turing costs at March 31, 2003
Lease cancellations and commitments.....	\$ 34,744	\$ --	\$ --	\$ (4,492)	\$ 30,252
Termination payments to employees and related costs.....	1,513	800	(68)	(2,162)	83
Write-off on disposal of assets and related costs.....	113	--	(94)	(10)	9
Total restructuring accrual and other.....	<u>\$ 36,370</u>	<u>\$ 800</u>	<u>\$ (162)</u>	<u>\$ (6,664)</u>	<u>\$ 30,344</u>
Less non-current accrued restructuring charges.....					(19,789)
Accrued restructuring charges included within other accrued liabilities.....					<u>\$ 10,555</u>

The charge to restructuring for employee-related costs of approximately \$0.8 million was due to a change in management estimates related to employee benefits plans adopted prior to January 1, 2003. Restructuring charges reversed in the quarter ended March 31, 2003 resulted from changes in management estimates relating to employee claims and the disposal price of equipment and other assets. The remaining accrued restructuring costs for Plans adopted prior to January 1, 2003 relate primarily to lease payments contractually required of us on certain facilities, net of any estimated sublease

amounts, expiring at various dates through 2011.

### *2004 Restructuring Activities*

	Accrued restruc- turing costs at December 31, 2003	Amounts charged to restruc- turing costs and other	Amounts paid or written off	Accrued restruc- turing costs at March 31, 2004
Lease cancellations and commitments.....	\$ 138	\$ --	\$ (35)	\$ 103
Accrued restructuring charges included within other current liabilities.....				\$ 103

During the three months ended March 31, 2004, approximately \$35,000 was paid to landlords for continued lease payments on facilities under lease through the end of 2004. All amounts accrued under this plan will be paid in full by December 31, 2004.

### **Amortization of Intangible Assets**

Amortization of intangible assets totaled approximately \$0.2 million in the three months ended March 31, 2004 compared to approximately \$0.1 million in the three months ended March 31, 2003. The amortization of intangible assets in these periods resulted from the acquisitions of Exterprise in 2001 and Mergent and AppNet during 2000. The approximate \$0.1 million decrease quarter over quarter in amortization is a result of impairments of various intangible assets and also certain intangible assets being subsumed by goodwill as part of the adoption of SFAS 141 "Business Combinations". Goodwill is no longer amortized in accordance with SFAS 142.

### **Interest Income and Other, Net**

Interest income and other, net in the three months ended March 31, 2004 of negative \$1.8 million was comprised of a \$2.4 million loss from the mark-to-market adjustment of our warrant liability, offset by an approximately \$0.4 million gain from a settlement on a previously disputed license receivable, and approximately \$0.2 million of interest income. Interest income and other, net in the three months ended March 31, 2003 was comprised of approximately \$0.7 million in currency differences and approximately \$0.3 million in interest income.

### **Interest Expense**

Interest expense in the three months ended March 31, 2004 was comprised of \$0.6 million in interest expense compared to approximately \$0.3 million in the three months ended March 31, 2003.

### **Provision for Income Taxes**

The income tax provision is the result of withholding and income taxes generated in certain foreign jurisdictions. Realization of our net deferred tax assets is dependent upon the generation of sufficient taxable income in future years in appropriate tax jurisdictions to obtain benefit from the reversal of temporary differences and from net operating loss carry forwards. Due to the uncertainty of the amount and timing of future taxable income, we have provided a full valuation allowance against the net deferred tax assets.

### **RISK FACTORS**

*If we are not able to raise additional capital, we encounter larger than anticipated expenses, or our revenues do not meet our expectations, our cash position may not be sufficient to sustain our business operations through 2004.*

As of March 31, 2004, we had approximately \$10.2 million in cash and cash equivalents, restricted cash and investments. Of this amount, approximately \$9.0 million represented unrestricted cash and short-term investments that we can use to fund

operations. Because our business operations currently use more cash than is generated, the cash used each quarter substantially reduces the cash available to fund our continuing operations and future capital requirements. Although we expect that our cash outflows will decrease as a result of our continuing expense reduction efforts, we will continue to have significant negative cash flows from operations.

In October 2003, we took additional steps to reduce our operational expenses, including further reductions in force. We believe that these actions, along with our planned cash collections and other expected cash inflows, will allow us to fund our operations through 2004. However, if we encounter unexpected expenses, we do not receive our expected cash collections or other cash inflows, or our revenues do not meet our expectations, we may not have sufficient funds to sustain our operations through the 2004 calendar year.

We believe that we will need to increase our revenues and/or raise additional capital to meet our liquidity and capital needs beyond 2004. As announced previously, the Company has retained Broadview International LLC to evaluate various strategic alternatives. Previously, we announced that we were considering the sale of our Supplier Relationship Management (SRM) applications. Although no assurance can be provided that such sale will not occur and plans and expectations are inherently uncertain, the Company is not currently actively pursuing the sale of such applications. Our \$5.0 million promissory notes with ComVest and DCC Ventures (the "ComVest Notes") are secured by, among other things, our SRM applications and a \$2.0 million note from eScout LLC issued to us in conjunction with the sale of our CommerceOne.net assets to eScout in January of 2003. We will need to repay the ComVest Notes at their maturity date in March 2005. The eScout note is due to be paid to us in January 2005 and the proceeds will need to be used for repayment to ComVest at such time pursuant to the terms of our agreement with Comvest, if the ComVest Notes have not yet been repaid. In addition, pursuant to the terms of a real estate settlement with PeopleSoft, Inc., our former landlord in Pleasanton, California, we owe Peoplesoft \$2.1 million on February 22, 2005 ("PeopleSoft Note"). As a result of these debt obligations, we believe that we will need to raise up to an additional \$7.0 million in order to meet our \$7.1 million repayment obligations on the PeopleSoft Note and the ComVest Notes which are due in February 2005 and March 2005, respectively. We believe that these amounts, in conjunction with our expected revenues, will provide us with sufficient cash to fund our operations through June 30, 2005. However, if actual revenues fall short of our expectations, we believe that we will need to raise approximately an additional \$2.0-5.0 million to fund our operations through June 30, 2005. In addition, we cannot currently estimate our specific financing needs beyond June 30, 2005, but may need to raise additional financing at that time. We may seek to raise additional capital through, among other things, potential asset sales, additional equity or debt financings, or some combination of these. The current unfavorable market for equity or debt financing makes it increasingly difficult to raise additional funding. In addition, the rights of our Series B Preferred Stock holder, BayStar, may discourage other potential investors and diminish our ability to obtain additional financing. If our revenues do not meet our expectations, we are unable to obtain additional financing, or we encounter expenses or cash outlays that are larger than expected, our remaining cash reserves may not be sufficient to sustain our operations through 2004 or beyond.

In addition, our Series B Preferred Stock will become redeemable on July 5, 2004 unless we are able to have declared effective and maintain the effectiveness of a registration statement covering the resale of underlying common stock. If BayStar chooses to exercise such redemption right at such time, we will not have sufficient cash to cover such redemption. If we do not have sufficient cash to fund our operations, we will need to pursue other alternatives such as the sale of some or all of our assets, dramatically reducing or discontinuing some or all of our operations or filing for bankruptcy protection. If we do file for bankruptcy protection, there can be no assurance that we can effectively reorganize under Chapter 11 of the Bankruptcy Code or that we would be able to earn sufficient proceeds from a liquidation under Chapter 7 of the Bankruptcy Code to pay all of our creditors or provide any proceeds to our stockholders.

***Our continued viability largely depends upon the success of our new Commerce One Conductor™ platform and our efforts to increase revenues from our SRM applications and services.***

As our business model has moved toward enterprise software solutions (i.e., sales to companies for their own internal use) and away from our historical focus on electronic marketplaces, we have developed a new composite application platform, called Commerce One Conductor. The Commerce One Conductor platform was released for general availability in March of 2003. The Commerce One Conductor platform and related solutions have been the primary focus of Commerce One's development and sales efforts, and our continued viability as a company depends in part upon our ability to release and deliver the products in a timely fashion and to establish a market for this relatively new category of products which may be perceived to depart from Commerce One's historical focus. Given the ongoing downturn in enterprise technology spending, the complexity and youth of our new technology, and the intense competition among enterprise software providers, our ability to generate a significant and sustainable market demand for our new solutions is uncertain. We also face concern from existing and potential customers as to our ongoing viability and our ability to provide long-term product support, which further inhibits our ability to sell our products. During 2003, revenues from sales of the Commerce One Conductor platform

represented a relatively small percentage of our license revenues, and we have continued to experience long sales cycles. In addition, in the quarter ended March 31, 2004, almost all of our revenues related to our SRM products and services and did not relate to Conductor sales. If we do not sell a significant number of licenses for our new Commerce One Conductor platform in the future, our revenues, and hence our business, will be significantly harmed.

In addition to our efforts to sell our Commerce One Conductor solution, we also plan to focus our sales efforts going forward on our SRM applications. In our most recent filings, we indicated that we were considering the sale of our Supplier Relationship Management (SRM) assets to generate additional necessary working capital. While there can be no assurance that we will not sell these assets in the future, we are not currently actively looking to sell our SRM assets. Currently, we plan to continue generating revenue through the direct license sales of SRM products and related services in conjunction with our direct license sales efforts relating to the Conductor platform. Our continued viability is in part dependent on our ability to generate increasing revenues through sales of SRM products and services. SRM revenues have been declining during the past 12 months and customers have been discontinuing maintenance services for such products as we shifted our focus away from such products and towards the Commerce One Conductor platform. We now plan to dedicate sales efforts focused on our SRM applications and we are creating a product development plan to enhance the SRM products. However, there can be no assurance that such efforts will increase our license or services revenues related to our SRM products. If we are unable to increase such revenues, our viability will be significantly harmed.

In addition, we depend on strategic relationships with certain technology providers for important functionality in our Commerce One Conductor platform and SRM applications. Some of these technology providers are relatively new and have limited operating histories. While our agreements with these providers contain various provisions protecting Commerce One's interests, there can be no guarantee that this technology will remain available to us on reasonable terms, if at all, in the long term. If we cannot maintain these relationships on reasonable terms, it may be difficult or costly to replace such technology, and our revenues and hence our business may be harmed.

***If we breach certain covenants we have made to BayStar in connection with their purchase of Series B Preferred Stock, including without limitation having our registration statement on Form S-3 declared effective on or before July 2, 2004 and maintaining our listing on either the Nasdaq National Market or SmallCap Market, or upon a change of control, we may be required to redeem the Series B Preferred Stock they have purchased which we may not have the cash or liquidity to do.***

If we do not timely convert shares of Series B Preferred Stock into common stock when requested, timely file, have declared effective and maintain the effectiveness of the registration statement on Form S-3 filed on August 22, 2003 covering the resale of the common stock underlying the Series B Preferred Stock, maintain the listing of our common stock on either the Nasdaq National Market or the Nasdaq SmallCap Market, or if we consummate a change of control (including a merger, acquisition or sale of all or substantially all of our assets), then BayStar may be able to require us to redeem all of the Series B Preferred Stock. The redemption price of this stock would be equal to the greater of 120% of the original purchase price plus any accrued and unpaid dividends or the value of the Series B Preferred Stock on an as-converted-to-common stock basis based on the closing bid price of our common stock on the day prior to the default or change of control. As of March 31, 2004, the estimated redemption price would have been approximately \$12,685,000. We initially filed our registration statement on Form S-3 on August 22, 2003, have since amended the filing in response to various comments from the SEC, and the registration statement has not yet been declared effective as of the time of this filing. The registration statement is subject to additional comments from the SEC and ensuring that it becomes effective is not entirely within our control. If the registration statement does not become effective on or prior to July 2, 2004, then BayStar may exercise the redemption right described above. Further, as of May 7, 2004, we did not meet the listing requirements of the Nasdaq National Market. If we are unable to regain compliance with these requirements, we could be subject to delisting from the Nasdaq National Market. If we are delisted from the Nasdaq National Market and are unable to transfer to and maintain a listing on the Nasdaq SmallCap Market, BayStar may also exercise its redemption rights.

In the event that BayStar chooses to exercise its redemption rights, we will not have the cash or liquidity to redeem such stock and our ability to fund our ongoing operations could be severely damaged. Further, in the event we were to consummate a transaction that constitutes a change of control, BayStar may choose to require us to redeem its shares at a premium as described above. If we do not have sufficient cash to fund our operations due to BayStar's exercise of its redemption right, we will need to pursue other alternatives such as the sale of some or all of our assets, dramatically reducing or discontinuing some or all of our operations or filing for bankruptcy protection. If we do file for bankruptcy protection, there can be no assurance that we can effectively reorganize under Chapter 11 of the Bankruptcy Code or that we would be able to earn sufficient proceeds from a liquidation under Chapter 7 of the Bankruptcy Code to pay all of our creditors or provide any proceeds to our stockholders.

***Our stock could be de-listed by the Nasdaq Stock Market's National Market, which could cause a decline in our stock price, hinder our stockholders' ability to trade their shares and undermine our ability to raise capital.***

We do not currently meet the listing requirements of the Nasdaq National Market. Under these listing requirements, we are among other things required to have stockholders' equity of at least \$10 million or a market capitalization of at least \$50 million. As of March 31, 2004, we had negative stockholders' equity and as of May 7, 2004, we had a market capitalization of approximately \$38.2 million. Further, if the market price of our common stock were to drop below one dollar for thirty consecutive trading days, and did not trade at or above one dollar per share for ten consecutive trading days during the following 180 calendar days, our stock could be de-listed. The closing sale price of our common stock on May 7, 2004 was \$1.04 per share.

If we are unable to regain and maintain compliance with the listing requirements of the Nasdaq National Market and are delisted, we will consider other alternatives, including applying for listing on the Nasdaq SmallCap Market, the OTC Bulletin Board or the "pink sheets." If we were to be de-listed from the Nasdaq National Market, it could make our stock more difficult to trade, reduce its trading volume, and further depress our stock price. De-listing could also weaken our ability to secure financing in the capital markets, which could materially impact our business operations and financial condition. If we are unable to transfer to the Nasdaq SmallCap Market and maintain a listing there, the holders of our Series B Preferred Stock would also have a right to redeem their shares. In addition, if we implement another reverse split in an attempt to increase the per share price of our common stock, the volatility of our stock could increase significantly because a second reverse split would severely reduce the number of our shares in the market and magnify the effect of large sales or purchases of our stock.

***Our executive officers and certain key personnel are critical to our business and if one or more of these officers and key personnel leave us, we may not be able to compete effectively and meet our operating goals.***

Our future success depends upon the continued service of our executive officers and other key personnel, and none of these individuals is bound by an employment agreement for any specific term. In addition, our ability to retain key personnel could be impacted by our various cost-cutting measures and continued workforce reductions. Any of these officers or employees may leave our organization in the future. In particular, the services of Mark Hoffman, our Chairman of the Board, Chief Executive Officer and President would be difficult to replace. In addition, our Chief Financial Officer, Charles Boynton, will be resigning from his position. Currently, we expect that his resignation will be effective on approximately May 31, 2004. Locating and educating a new CFO will require management time and resources and may disrupt our operations. We may also have difficulty executing our CFO transition plan successfully as a result of new regulatory requirements mandated by the Sarbanes Oxley Act. In particular, the SEC's new rules related to internal controls over financial reporting and management's assessment of the effectiveness of these controls may be more difficult to comply with. If we lose the services of one or more of our executive officers or key employees, or if one or more of them decides to join a competitor or otherwise compete directly or indirectly with us, our business, operating results and financial condition may be seriously harmed.

***Our limited operating history and a history of losses may limit our ability to raise additional capital, sell our products and services and fund continued operations.***

We have not been profitable in our recent history and as of March 31, 2004, we had an accumulated deficit of \$3.7 billion. We will need to generate significant additional revenues to avoid losses in the future. If we do not decrease our losses in the future, our business may suffer in a number of ways, including increased difficulties in obtaining additional capital, selling our products and services (since nearly all customers require future support) and funding our continued operations.

***The current downturn in general economic conditions and current global unrest may decrease our revenues.***

The current recession and uncertainty in global economic and market conditions have decreased and may continue to decrease demand for our products and services. If the current economic downturn continues or worsens, our business, financial condition and results of operations could be seriously harmed. In addition, the September 11, 2001 terrorist attacks in the United States, the subsequent U.S. military operations abroad, and potential future related events may adversely affect our business. Primarily as a result of economic conditions, spending on enterprise software has been dramatically reduced across industries. As a result, we have experienced decreased demand and may continue to experience decreased demand for our products and services. In addition, the economic downturn has made it increasingly difficult for companies, in particular technology companies, to raise capital. If general economic conditions do not improve, we may not be able sufficiently increase revenues or raise capital to continue operations, regardless of our operating expense reductions and the introduction of new products.

***Fluctuations in our quarterly results may cause our stock price to decline and make it difficult for us to forecast quarterly revenue and operating results.***

Our quarterly results have fluctuated in the past and may fluctuate significantly in the future as a result of a variety of factors, many of which are outside of our control. It is likely that our results in one or more future quarters may be below the expectations of securities analysts and investors. In that event, the trading price of our common stock almost certainly would decline.

We are required by generally accepted accounting principles to adjust the warrant liability reflected in our balance sheet at March 31, 2004, to fair value at the end of each quarter and record a charge or a benefit in our statement of operations for the amount of the adjustment. The fair value of our warrant liability could fluctuate significantly based on changes in the value of our common stock and other factors which are outside of our control, which could result in significant fluctuations to our quarterly results.

Additional factors that may affect our quarterly results include the following:

- the timing of introductions or enhancements of our products and services or our competitors;
- the demand for and the price that customers are willing to pay for our new and unproven products and related services, particularly the Commerce One Conductor platform and related product offerings that are the primary focus of our future sales efforts;
- market acceptance of our new products;
- the mix of products sold by us;
- changes in our pricing policies or our competitors;
- changes in our sales incentive plans;
- our sales cycles are relatively long, often six months or longer, and may result from delays in the budgeting cycles of our customers that are difficult to predict;
- nonrenewal of our maintenance agreements, which generally automatically renew for one-year terms unless earlier terminated by either party upon 90-days notice;
- product life cycles;
- changes in strategy, such as our change in focus from our SRM and electronic marketplace products to our new Commerce One Conductor platform;
- seasonal trends;
- the mix of distribution channels through which our products are sold;
- the mix of international and domestic sales;
- the rate at which new sales people become productive; and
- changes in the level of operating expenses to support projected growth.

Due to these and other factors, it is difficult to accurately forecast our quarterly revenues and operating results. We believe that period-to-period comparisons of our operating results may not be meaningful and you should not rely upon them as any indication of our future performance.

***Our restructuring initiatives and divestitures may not reduce our operating expenses sufficiently and could result in business distractions or negative market perception that reduce our ability to close revenue transactions.***

We implemented restructuring plans throughout 2002 and 2003. The primary objectives of our restructuring plans have been to reduce our operating expenses and to focus on new products. We also implemented certain strategic initiatives designed to strengthen our operations. These plans include without limitation, reductions in our workforce and facilities, improved alignment of our organization around our core business objectives and realignment of our sales force, professional services and general and administrative functions. Workforce reductions temporarily impact our remaining employees, including those directly responsible for sales or services, which may affect their productivity and hence, our future revenues. In addition, the failure to retain and effectively manage remaining employees could increase our costs and hurt our development and sales efforts.

In addition, in early 2003, we divested certain services operations, including CommerceOne.net, our hosted services offering, and we may engage in similar divestitures in the future. While we believe that such divestitures benefit us by reducing overall costs and allowing us to focus on our core business objectives, such divestitures reduce overall revenue in the short term. Additionally, divestitures could cause disruption for our remaining and transitioning employees, reducing overall productivity. Workforce reductions, strategy changes and divestitures also can affect our ability to close revenue transactions with our customers and prospects. For example, as we have shifted our focus to our new Commerce One Conductor™ platform, we face concerns from current and potential customers of our SRM solutions about our ongoing support and maintenance of those products, which can hinder sales opportunities for such products. Failure to achieve the desired results of our restructuring initiatives and divestitures could harm our business, operating results and financial condition.

***Sales of a substantial number of shares of our common stock by certain of our stockholders could cause the market price of our common stock to decline and make it more difficult for us to raise financing.***

A substantial percentage of our outstanding common stock is held by SAP AG and Ford Motor Company. We believe that SAP continues to beneficially own approximately 20% of our outstanding common stock. SAP is currently subject to only limited restrictions on its ability to sell its shares. We believe that as of May 10, 2004, Ford Motor Company owned 1,440,000 shares of our common stock, or approximately 3.9% of our outstanding common stock. The contractual restrictions on the ability of Ford to sell its shares terminated on December 8, 2003. The contractual restrictions on SAP's ability to sell its shares effectively prohibit SAP from transferring more than 50% of its shares in open market transactions prior to June 28, 2004, and any transfers it may make are subject to certain other limitations on open market sales and transfers to persons who after the transfer will hold in excess of 10% of our voting power. In addition, these stockholders possess certain registration rights that will, in certain circumstances, require us to register these stockholders' resale of their shares.

In July 2003, we issued 100,000 shares of Series B Preferred Stock to BayStar that are initially convertible into approximately 4,297,748 shares of our common stock. The number of shares of common stock issuable upon conversion of the Series B Preferred Stock may increase over time pursuant to the dividend payments. We also issued to BayStar warrants to purchase an additional 2,209,945 shares of our common stock. We filed a registration statement on Form S-3 with the SEC on August 22, 2003 to register the resale of the common stock issuable upon conversion and exercise of these securities. Furthermore, SAP has exercised its right to have the resale of 5,254,431 shares of our common stock included in this registration statement, which SAP could sell subject to the contractual limitations described above. Once this registration statement is declared effective by the SEC, BayStar may decide to convert some or all of the Series B Preferred Stock into common stock, and such common stock would be freely tradable in the public market. In addition, in December, we issued secured promissory notes to ComVest Investment Partners II LLC and DCC Ventures, LLC that are potentially convertible into a maximum of 4,085,346 shares of our common stock. In connection with this transaction, we also issued warrants to purchase an aggregate of 2,568,494 shares of our common stock to ComVest and DCC Ventures which they have fully exercised. We filed a Registration Statement on Form S-3 with the SEC on April 5, 2004 to register the resale of the shares of common stock issued to ComVest and DCC Ventures, upon exercise of the warrants and potentially issuable upon conversion of their promissory notes. In addition, BayStar required us to include in this Registration Statement 500,000 shares of our common stock issued to BayStar in March 2004. As a result, these stockholders may be able to sell a significant number of shares of our common stock on the open market in a short period of time. These sales, or the perception that these sales may occur, could cause the market price of our common stock to decline and could make it more difficult for us to raise equity financing in the future.

***If we ever liquidate Commerce One, outstanding shares of Series B Preferred Stock will receive a liquidation preference over our common stock and, if proceeds are not sufficient to pay the entire liquidation preference, holders of common stock may not receive anything.***

If we ever liquidate Commerce One, the outstanding shares of Series B Preferred Stock will receive a liquidation preference over our common stock. The Series B Preferred Stock liquidation preference per share is equal to the greater of the initial purchase price plus any accrued and unpaid dividends (or an aggregate of \$10 million plus any accrued and unpaid dividends based on the current outstanding shares of Series B Preferred Stock) or the value of the Series B Preferred Stock on an as converted to common stock basis plus any accrued and unpaid dividends. The liquidation preference reduces the amount of proceeds available to the holders of our common stock in a liquidation of the company's assets and, if the proceeds are not sufficient to pay the entire liquidation preference, there may not be any proceeds available for the holders of common stock following such liquidation.

***Certain of our assets used to secure our recently issued promissory notes to ComVest and DCC could be jeopardized if we are unable to pay the notes in accordance with their terms.***

On December 31, 2003, we issued secured promissory notes in the aggregate principal amount of \$5 million to ComVest Investment Partners II LLC and DCC Ventures, LLC in a private placement with a maturity date of March 31, 2005. The notes are secured by certain assets related to our SRM business and certain promissory notes issued to us by eScout LLC in the aggregate principal amount of \$2,000,182. We may prepay the notes at any time without penalty or premium. The notes must be prepaid in the event that we sell our SRM business, the assets related to our SRM business and/or the promissory notes issued to us by eScout or raise additional debt or equity financing. The notes will mature early if we are acquired, sell all or substantially all of our assets, undergo a change of control, or one business day prior to the date on which we pay all or substantially all amounts outstanding under a promissory note payable to PeopleSoft. In the event we fail to pay the notes in accordance with their terms upon maturity, upon an event of default, or upon a merger, sale or change of control of the Company, or the sale, transfer or disposition of all or substantially all of the Company's assets (other than the sale of the



Company's SRM assets), ComVest and DCC Ventures may convert their notes into shares of our common stock equal to the number obtained by dividing the then-outstanding principal amount of such notes, together with all accrued but unpaid interest thereon, by the conversion price, subject to adjustment for stock splits, stock dividends, reclassifications and the like. The conversion price per share is equal to 90% of the average closing bid price for the 5 trading days immediately following the later of the date of such event and the date of issuance of any press release announcing such event.

***If we are unable to increase revenues generated from license fees, our gross margins will decline.***

In most cases, our license revenues have a higher gross margin percent than our services revenues. Our services revenues represented a significant percentage of total revenues in the first quarter of 2004, constituting 90% of total revenues. To the extent that services revenues continue to increase as a percentage of our total revenues, our overall gross margin will continue to decline. If we are not successful in increasing revenues from license fees, or we are not successful in increasing the gross margin of our services fees, our overall gross margins will suffer. For example, we had expected that most of our license revenues in 2003 would be derived from the sale of our new Commerce One Conductor™ platform, which was released for general availability in March of 2003 and remains largely untested in the market. As it turned out, we did not generate significant license fees from the sale of the Conductor product in 2003. For example, we announced in October 2003 that our expected license revenues for the third quarter were 70% lower than we had previously forecasted in July 2003. If we are not able to generate significant license fees from our new solutions, our gross margins will suffer. Our expenses related to the cost of licenses sold are relatively fixed in the near term, and if our license revenues continue to decline any further, such a decline would have a disproportionately adverse impact on our gross margins reported in the near term.

***Managing operations in a changing environment could strain our management and cause our operations to suffer.***

Our ability to successfully offer products and services and implement our business plan in a rapidly evolving market requires an effective planning and management process. In 1999 and 2000, we experienced significant growth in our workforce and expenditures, followed by a significant decline in 2001, 2002 and 2003. These changes place a strain on our managerial resources and make planning more difficult. While we manage these rapid changes, we must also compete effectively and manage our operations by maintaining and enhancing our financial and accounting systems and controls, integrating new and existing personnel and managing operations with fewer personnel. If we cannot effectively manage and plan in this rapidly changing environment, our operations will suffer.

***We may experience difficulty collecting on our accounts due to the nature of some of our customers.***

Some of our customers are small emerging growth companies with limited credit operating histories that are operating at a loss and have limited access to capital. With the significant downturn in the economy and uncertainty relating to the prospects for near-term economic growth, some of these customers represent a credit risk. In addition, a small number of our customers historically have accounted for a significant amount of our accounts receivable. At March 31, 2004, no customer accounted for 10% or more of our gross accounts receivable balance. If our customers experience financial difficulties or are otherwise unable to pay us amounts owed, we may have difficulty collecting on our accounts receivable and may need to institute litigation in an attempt to collect such amounts. Even if we instituted such litigation, we cannot be assured that we would collect such amounts. If we are unable to collect our accounts receivable, our cash position would suffer materially.

***In the event we are unable to satisfy regulatory requirements relating to internal controls, or if these internal controls over financial reporting are not effective, our business could suffer.***

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we will be required during 2004 to perform an evaluation of our internal controls over financial reporting and have our auditor publicly attest to such evaluation. We have prepared an internal plan of action for compliance, which includes a timeline and scheduled activities, although as of the date of this filing we have not yet prepared the evaluation. Compliance with these requirements is expected to be expensive and time-consuming. If we fail to timely complete this evaluation, or if our auditors cannot timely attest to our evaluation, we could be subject to regulatory scrutiny and a loss of public confidence in our internal controls.

In designing and evaluating our internal controls over financial reporting, we recognize that any internal control or procedure, no matter how well designed and operated, can provide only reasonable assurance of achieving desired control objectives. For example, a company's operations may change over time as the result of new or discontinued lines of business and management must periodically modify a company's internal controls and procedures to timely match these changes in its business. In addition, management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures and company personnel are required to use judgment in their application. While we believe that our internal controls over financial reporting currently provide reasonable assurance of achieving their control objectives, no

system of internal controls can be designed to provide absolute assurance of effectiveness. A material failure of internal controls over financial reporting could materially impact our reported financial results and the market price of our stock could significantly decline. Additionally, adverse publicity related to a material failure of internal controls over financial reporting would have a negative impact on our reputation and business.

***In the event the purchasers of our convertible promissory notes and warrants in December 2003 were deemed to have the right to rescind the purchase of the notes and warrants, we could effectively be required to redeem the notes sooner than their March 2005 maturity date.***

In the event that our issuance of \$5.0 million of convertible promissory notes and related warrants in December 2003 were deemed to be integrated with our pending registration statement covering the resale of securities sold in July 2003, it is possible that the issuance of the notes and warrants would not be viewed as valid private placement under the Securities Act of 1933 and related rules and regulations. If this were found to be the case, the purchasers of the notes and warrants would potentially have the right to rescind their purchases. Such rescission may require us to redeem the notes at their face amount of \$5.0 million, and the related warrants for their aggregate purchase price of \$100, together with interest. To the extent that the purchasers were to make such a claim and prevail in a timely fashion, we could effectively be required to redeem the notes sooner than their existing March 2005 due date. To date, however, none of the purchasers of the notes and warrants have sought to rescind their purchases or indicated any intention to do so. In addition, if such claims were made, we believe that we would have meritorious defenses to these claims.

***If we are not able to retain essential personnel, we may not be able to meet our operational goals.***

Our future performance depends on the continued service of certain key employees. Our ability to retain key employees is becoming more difficult given the decline in our business, the drop in our stock price, our prolonged and ongoing cost-cutting measures, and overall employee concerns about our ongoing viability. This is of particular concern in our Engineering group, where a relatively small number of employees have control over, and knowledge of, our source code and product information. To the extent we replace any employees who resign, those new hires may require extensive training before they achieve effective levels of productivity. If we fail to retain our key employees or to attract other highly qualified personnel, our business will suffer.

***Our significant reductions in our professional services group may hinder our ability to sell our products and may cause us to depend more heavily upon creating relationships with third-party systems integrators to support our new solutions.***

Our success depends upon the acceptance and successful implementation and integration by our customers of our products. We have implemented reductions in our workforce throughout 2001, 2002 and 2003, which included significant reductions in our professional services headcount. While we believe that these actions were necessary in order to reduce operating expenses and to realign our organization to focus on our core products, these reductions may be perceived negatively by potential customers who require integration services in connection with the purchase of a product license and may therefore hinder our ability to sell our products. As a result of these downsizings, and/or due to existing relationships between our customers and third party systems integrators, our current and potential customers often rely on third-party systems integrators such as Accenture, EDS, Computer Sciences Corporation, IBM and others to develop, deploy and manage their composite management platforms and solutions. We, and our customers, will need to continue to rely on these systems integrators, particularly in light of the recent downsizings of our Global Services division, which competes with these systems integrators to some extent. Thus far, systems integrators are largely unfamiliar with our Commerce One Conductor™ platform, as it is a new product that was released in March 2003. If we are unable to generate support of our new solutions from large systems integrators, particularly our Commerce One Conductor™ platform, or if any of our customers or suppliers are unable to successfully integrate our solutions, our business, operating results and financial condition could suffer.

In addition, we cannot control the level and quality of service provided by our current and future third-party integrators. While our agreements with those integrators normally include provisions designed to ensure quality, those provisions are often difficult to enforce and cannot guarantee acceptable quality in all cases. If our customers experience quality problems arising from installation of our software by these third parties, we may experience negative customer reactions, adverse publicity, or even legal claims. If such problems are significant, our reputation, financial condition and ultimately our business may be harmed.

***Our services revenue and operating results will suffer if we are not able to maintain our prices and utilization rates for our professional services, as well as our pricing for our support and maintenance services.***

The rates we are able to charge for our professional services and the utilization, or chargeability, of our professional services organization are a large component of our overall gross margin, and therefore our operating results. Accordingly, if we are not able to maintain the rates we charge for our professional services or an appropriate utilization rate for our professionals, we will not be able to sustain our gross margin and our operating results will suffer. When we introduced our new

Commerce One Conductor™ platform, we entered into arrangements with a limited number of “early adopter” customers (customers who agreed to use the beta form of the product) where certain of our services are offered without charge or at significantly reduced fees, reducing our overall gross margins. If we are unable to replace those limited offerings with substantial services projects at our normal rates, then our services revenues, utilization rates and gross margins from services will suffer. The rates we are able to charge for our professional services are affected by a number of factors, including our customers’ perceptions of our ability to add value through our professional services, competition, the introduction of new services or products by us or our competitors, the pricing policies of our competitors, and general economic conditions. Our utilization rates are also affected by a number of factors, including seasonal trends, primarily as a result of our hiring cycle and holiday and summer vacations, our ability to transition employees from completed projects to new engagements, our ability to forecast demand for our professional services and thereby maintain an appropriate headcount, and our ability to manage attrition. If we are unable to maintain our prices and utilization rates for our professional services, our margins and our operating results will be harmed.

We also have licensed source code to certain customers for some of our products for limited purposes. Although those source code license sales have generated short-term revenue, in the longer term they will reduce our services revenue stream because those customers have less need for customer support or professional services. If, over the long term, we cannot generate enough license sales to offset this lost services revenue, our business will suffer.

In addition, maintenance and support services represent a significant component of our services revenues. As we have shifted our focus to our Commerce One Conductor platform, certain of our maintenance and support customers have reduced, cancelled or otherwise renegotiated terms for the provision of our support and maintenance services for our SRM or marketsite-focused products. As a result, some of these customers have reduced these services—which has reduced our overall support and maintenance revenues—and/or migrated to shorter-term payments, which affects the stability of those revenues. If we are unable to replace this revenue with support and maintenance revenue from our Commerce One Conductor™ platform product on our standard maintenance payment terms, our services revenue and operating results may suffer.

***Our strategy of outsourcing development and maintenance of certain products to an offshore partner may not achieve the desired cost reductions or other expected results and could reduce the quality of our products or increase the chance of infringement of our intellectual property rights.***

In the course of restructuring initiatives during 2002 and in early 2003, we reduced our engineering headcount significantly. In early 2003, we entered into an outsourcing agreement with Satyam Computer Services Limited, a software development firm located in India, to perform product development work for certain of our software applications. Although we have significantly scaled back our product development efforts, we may continue to use Satyam occasionally in the future. While we have implemented various quality control measures in our outsourcing agreement with Satyam, we cannot guarantee the level and quality of service it will provide. If Satyam does not provide the expected results, our customers may experience quality problems and we may experience negative customer reaction, adverse publicity, or even legal claims. If such problems are significant, our reputation, financial condition and ultimately our business may be harmed.

Additionally, providing broad access to our software code and related intellectual property to an offshore entity increases the opportunity for infringement of the patent, trademark, copyright and trade secret rights in our software products. This is particularly true as a significant portion of the development work is performed in India, where intellectual property protections differ from those in the United States and may be difficult to enforce. If our intellectual property rights are infringed, we may need to engage in costly litigation efforts to enforce such rights. As a result, our financial condition and business may be substantially harmed.

***Our industry is highly competitive and has low barriers to entry, and we cannot assure you that we will be able to compete effectively.***

Because the market for composite process management solutions is extremely competitive, we may suffer a loss of business and a reduction in the prices we can charge for our products and services. We have experienced competitive price pressure over the last two years and the average license fee for our products has decreased substantially over time due to the economic downturn and the shift of our focus to the highly competitive market of enterprise software applications. We expect competition to intensify as current competitors expand their product offerings and new competitors enter the market. There are relatively low barriers to entry in the composite process management market, and competition from other established and emerging companies may develop in the future. In addition, our customers and partners may become competitors in the future. Increased competition is likely to result in price reductions, lower average sales prices, reduced margins, longer sales

cycles and a decrease or loss of our market share, any of which could harm our business, operating results or financial condition. Our competitors include webMethods, Inc., BEA, See Beyond, and other enterprise application integration (EAI) vendors, as well as other companies with web services offerings such as IBM, Microsoft, SAP AG, and Oracle Corporation, among others. Our Global Services division competes against many consulting companies, including many of our integration partners. Certain of these competitors jointly offer composite process management and web services solutions to potential customers. These joint efforts could intensify the competitive pressure in our market. Many of our competitors, and new potential competitors, may have a longer operating history, larger technical staffs, larger customer bases, more established distribution channels and customer relationships, greater brand recognition and greater financial, marketing and other resources than we have. In addition, competitors may be able to develop products and services that are superior to our products and services, that achieve greater customer acceptance, or that have significantly improved functionality as compared to our existing and future products and services. The solutions offered by competitors may be perceived by buyers and suppliers as superior to ours.

***Our revenues may not grow if we cannot resell our products through strategic relationships.***

We have established limited strategic relationships with companies that resell and distribute our products to our customers, primarily in international locations. This strategy is unproven and, to date, some of our partners have been unsuccessful in reselling our products. Unless we are able to sell more of our products through resellers, our revenues and our business will continue to suffer.

***Our efforts to reduce expenses by closing foreign operations have been hindered by employment laws in some of those locations.***

As part of our ongoing effort to manage our expenses and improve our financial condition, we have chosen to reduce and/or cease operations in a number of foreign locations. While those reductions and closures may be advantageous in the long run, the short-term costs have been significant in some of those locations due to restrictive employment laws and the relatively high cost of severance payments. Given the high cost of scaling back our international operations, we cannot assure you that we will ever realize the financial benefit of taking those steps, which have had, and may continue to have, negative consequences on our near-term financial condition through at least the first half of 2004.

***Because our business remains partially international, we continue to face numerous obstacles in other countries that increase our costs to do business.***

A portion of our sales are made to customers in foreign countries. International business involves inherent difficulties and costs that may affect us or adversely affect our business or results of operations, including:

- longer payment cycles and greater difficulty in collecting accounts receivable;
- difficulties in servicing foreign customers after closing all of our foreign offices;
- the impact of recessions in economies outside the United States;
- the impact of different employment laws in other countries, including without limitation laws providing for significant severance payments and benefits under certain circumstances;
- the global impact of armed or political conflicts;
- political instability;
- price controls or other restrictions on foreign currency;
- potentially harmful tax consequences, including withholding tax issues;
- fluctuating exchange and tariff rates;
- difficulty in protecting intellectual property;
- difficulties in obtaining export and import licenses;

- delays, difficulties and expenses associated with discontinuing operations in certain countries;
- foreign antitrust regulation; and
- inadequate technical and other infrastructure.

We also have only limited experience in marketing, selling, implementing and supporting our products and services outside the United States. These difficulties may adversely affect our business.

***Product liability claims or other claims regarding the performance of our products or the nature of our services may harm our reputation, increase our costs, or decrease our revenues.***

We may be subject to product liability claims or other claims regarding the performance of our products, even though our license agreements typically seek to limit our exposure to such claims, because the contract provisions of our license agreements may not be sufficient to preclude all potential claims. Similarly, we design, develop, implement and manage solutions that are often crucial to the operation of our customers' businesses. Customers who are not satisfied with these services could bring claims against us for substantial damages. Additionally, our general liability insurance may be inadequate to protect us from all liabilities that we may face. The successful assertion of one or more large claims that are uninsured, exceed insurance coverage, or result in changes to insurance policies, including premium increases, could have a material adverse effect on our business, financial condition or results of operations. We could be required to spend significant time and money litigating these claims, or, where necessary, pay significant damages. Such claims could also result in lost revenues, adverse publicity and negative customer reaction. As a result, any claim, whether successful or not, could harm our reputation, operating results, financial condition and ultimately our business.

***If third parties claim that we infringe upon their intellectual property rights, our ability to use certain technologies and products could be limited and we may incur significant costs to resolve these claims.***

Our business depends upon intellectual property, and litigation regarding intellectual property rights is common in the Internet and software industries. Intellectual property ownership issues may be complicated by the fact that our Global Services division has often developed intellectual property for its clients and, in order to carry out projects, frequently receives confidential client information. If an intellectual property infringement claim is filed against us, we may be prevented from using certain technologies and may incur significant costs to resolve the claim. In addition, we generally indemnify customers against claims that our products infringe upon the intellectual property rights of others. We could incur substantial costs in defending ourselves and our customers against infringement claims. In the event of a claim of infringement, we and our customers may be required to obtain one or more licenses from third parties. We or our customers may not be able to obtain necessary licenses from third parties at a reasonable cost, or at all.

***Because the protection of our proprietary technology is limited, our proprietary technology could be used by others, which could increase our competition and lead to costly litigation.***

Our success depends, in part, upon our proprietary technology and other intellectual property rights. To date, we have relied primarily on a combination of copyright, patent, trade secret, and trademark laws, and nondisclosure and other contractual restrictions on copying and distribution to protect our proprietary technology. We have five issued patents to date. We may not be able to protect our intellectual property rights adequately in the United States or abroad. In particular, we sometimes license the use of the source code to certain of our applications to our customers on a limited basis. We also have an outsourcing agreement with Satyam Computer Services Limited, an offshore entity, which allows Satyam entity broad access to certain of our applications. While we have included many contractual provisions in our agreements designed to limit the use of such code and to protect our intellectual property rights, we cannot assure you that such protections are sufficient to prevent infringement. In addition, some countries outside the United States have less stringent protections on intellectual property and our rights may be difficult to enforce in such jurisdictions. Furthermore, litigation may be necessary to enforce our intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Such litigation could result in substantial costs and diversion of resources and could harm our business, operating results and financial condition.

***Our participation in organizations creating web services standards may increase the chance that our intellectual property rights are infringed, which could increase our competition and reduce our revenues.***

We participate in a number of organizations for the purpose of establishing standards in the evolving Web Services area. While we believe our participation benefits Commerce One by allowing us to influence standards in a way that is favorable for our technology, our participation also presents certain risks to the intellectual property rights in our technology. These risks include, but are not limited to, the fact that these organizations generally require participating companies to reveal certain aspects of their intellectual property and to provide a limited grant of intellectual property rights to other participating companies. Such requirements can increase the risk that our intellectual property rights will be infringed.

***We may not have adequate back-up systems, and a disaster could damage our operations, reduce our revenues and lead to a loss of customers.***

We do not have fully redundant systems for service at an alternate site. A disaster could severely harm our business because our service could be interrupted for an indeterminate length of time. Our operations depend upon our ability to maintain and protect our computer systems at our facility in Santa Clara, California, which reside on or near known earthquake fault zones. Although these systems are designed to be fault tolerant, they are vulnerable to damage from fire, floods, earthquakes, power loss, acts of terrorism, telecommunications failures and similar events. In addition, our facilities in California could be subject to electrical blackouts if California faces another power shortage similar to that of 2001. Although we do have a backup generator, which would maintain critical operations, this generator could fail. We also have significantly reduced our workforce in a short period of time, which has placed different requirements on our systems and has caused us to lose personnel knowledgeable about our systems and which may make it more difficult to quickly resolve potential system disruptions. Disruptions in our internal business operations could harm our business by resulting in delays, disruption of our customers' business, loss of data, and loss of customer confidence.

***Provisions of our charter documents and Delaware law could make it more difficult for a third party to acquire us even if the offer may be considered beneficial by our stockholders.***

Our certificate of incorporation and bylaws contain provisions, which could make it harder for a third party to acquire us without the consent of our Board of Directors. Among other things, our Board of Directors has adopted a shareholder rights plan, or "poison pill," which would significantly dilute the ownership of a hostile acquirer. In addition, Section 203 of the Delaware General Corporation Law limits business combination transactions with 15% stockholders that have not been approved by the Board of Directors. We also have entered into agreements with some of our strategic investors that, to an extent, limit their ability to attempt to acquire us without board approval. In addition, certain features of our Series B Preferred Stock that could require an acquiror to give the holders of Series B Preferred Stock similar rights in the acquiror may make us less attractive to potential buyers. All of these provisions make it more difficult for a third party to acquire us without negotiation. These provisions may apply even if the offer may be considered beneficial by our stockholders.

***Changes in accounting standards and in the way we charge for licenses could result in a reduction of the revenue we are able to recognize.***

In October 1997, the American Institute of Certified Public Accountants issued its Statement of Position 97-2, "Software Revenue Recognition," and later amended its position by its Statement of Position 98-4 and Statement of Position 98-9. Based on our interpretation of the AICPA's position, we believe our current revenue recognition policies and practices are consistent with Statement of Position 97-2, Statement of Position 98-4 and Statement of Position 98-9. However, interpretations of these standards continue to be issued. Future interpretations could lead to unanticipated changes in our current revenue recognition practices, which could materially adversely affect our business, financial condition and operating results.

The Securities and Exchange Commission and the Financial Accounting Standards Board are also currently reviewing the accounting standards related to other areas. Any changes to these accounting standards, or the way these standards are interpreted or applied, could require us to change the way we account for any other aspects of our business in a manner that could adversely affect our reported financial results.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The following discusses our exposure to market risk related to changes in interest rates, foreign currency exchange rates and equity prices. This discussion contains forward-looking statements that are subject to risks and uncertainties. Actual results could vary materially as a result of a number of factors including those set forth in the section entitled "Risk Factors".

#### ***INTEREST RATE RISK***

As of March 31, 2004, we had total restricted and unrestricted cash, highly liquid investments and short-term investments of approximately \$10.2 million. These investments may be subject to interest rate risk and will decrease in value if market interest rates decrease. A hypothetical increase or decrease in market interest rates by 10 percent from the market interest rates at March 31, 2004 would cause the fair market value of these investments to change by an immaterial amount. Declines in interest rates over time will, however, reduce our interest income.

#### **FOREIGN CURRENCY EXCHANGE RATE RISK**

Substantially all of our revenues recognized to date have been denominated in U.S. dollars, a significant portion of which have been transacted with customers outside the United States. To the extent that we engage in international sales denominated in U.S. dollars, an increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive in international markets. We will continue to monitor our exposure to currency fluctuations and although we have never used financial hedging techniques to date, we may use them in the future to minimize the effect of these fluctuations. Nevertheless, we cannot assure you that these fluctuations will not harm our business in the future.

#### **EQUITY PRICE RISK**

From time to time, we have made investments in private companies, particularly private companies that are our strategic partners or customers. As of March 31, 2004, our investment in private companies had an immaterial carrying value. These investments are illiquid and there is currently no market for these investments. If these companies do not complete initial public offerings or are not acquired by publicly traded companies or for cash, we may not be able to liquidate these investments. In addition, even if we are able to sell these investments we cannot assure you that we will recoup our investment.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) or 15d-15(e) under the Exchange Act, as of March 31, 2004. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

#### **Changes in Internal Control Over Financial Reporting**

There were no changes in our internal controls over financial reporting during the quarter ended March 31, 2004, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## **PART II—OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

We currently are a party to various legal proceedings, including those noted below. While management currently believes that the ultimate outcome of these proceedings will not have a material adverse effect on our results of operations, litigation is subject to inherent uncertainties, and unfavorable rulings could occur. Depending on the amount and timing, an unfavorable outcome of some or all of these matters could have a material adverse effect on our cash flows, business, results of operations or financial position.

#### **Securities Litigation**

On June 19, 2001, a class-action securities claim, captioned *Cameron v. Commerce One, Inc., et al.*, was filed against Commerce One, several company officers and directors (the “Individual Defendants”), and the three lead underwriters in the Commerce One initial public offering (“IPO”) in the United States District Court for the Southern District of New York. Various plaintiffs have filed similar actions asserting virtually identical allegations against more than 200 other companies. The lawsuits against Commerce One and other companies have been coordinated for pretrial purposes with these other related lawsuits and have been assigned the collective caption *In re Initial Public Offering Securities Litigation*.

On April 19, 2002, plaintiffs' lawyers for the coordinated lawsuits filed an amended complaint consisting of a set of "Master Allegations" and individual amended complaints against the various defendants, including Commerce One and the Individual Defendants. The amended complaint alleges violations of Section 11 and Section 15 of the Securities Act of 1933, Section 20(a) of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 10(b) of the Exchange Act (and Rule 10b-5, promulgated thereunder) as a result of alleged conduct of the underwriters of the IPO to engage in a scheme to under price the IPO and then artificially inflate our stock price in the aftermarket. The complaint seeks unspecified damages on behalf of a purported class of purchasers of common stock between July 1, 1999 and June 15, 2001. On July 15, 2002, the issuer defendants and individual defendants filed an omnibus motion to dismiss addressing issues generally applicable to the defendants as a group. On October 9, 2002, the district court entered an order dismissing all of the living individual Commerce One officers and directors from the case without prejudice. On February 16, 2003, the district court entered an order denying most of the defenses asserted by the defendants in the omnibus motion to dismiss and allowing most of the case to proceed. A proposal has been made for the settlement and release of claims against the issuer defendants, including Commerce One. Under the settlement proposal, the plaintiffs would dismiss the issuer defendants from the lawsuit (including Commerce One and named individual defendants) and continue to pursue their case against the underwriter defendants. In exchange for this dismissal, the D&O insurance carriers would agree to guarantee a recovery by the plaintiffs from the underwriter defendants of at least \$1.0 billion. Our Board of Directors has approved Commerce One's participation in the settlement. The settlement remains subject to a number of conditions, including approval of the proposed settling parties and the court. If the settlement does not occur, and litigation against Commerce One continues, we believe we have meritorious defenses and intend to defend the case vigorously.

In February 2003, Commerce One, along with its Chief Executive Officer and former Chief Financial Officer, were named as defendants in a similar class-action matter in Florida, *Liu v. Credit Suisse First Boston et al.*, United States District Court, Southern District of Florida. In that case, the plaintiff alleges that various investment banks, issuer companies, and individuals violated securities laws by engaging in a scheme to under-price initial public offerings and then artificially inflate prices of those stocks in the aftermarket. The Commerce One defendants have been dismissed from the case. By court order dated July 16, 2003, the court declined to grant the plaintiff's motion to vacate its order of dismissal, finding that plaintiff lacked good cause for failing to effect service on the dismissed defendants, including Commerce One. This case also has been coordinated with the other similar class-action securities cases pending in New York, including the *Cameron* matter described above, and it remains unclear whether the proposed settlement of those other cases will apply to the claims in the *Liu* matter.

#### ***Other Litigation***

In December 2003, Commerce One entered into a settlement agreement with Covisint pursuant to which Covisint paid the Company \$4,650,000. This payment was made in full on or before January 2, 2004. In connection with this agreement, the Company's existing technology agreement with Covisint has been cancelled, and Covisint's future payment obligations to the Company under such agreement have terminated.

### **ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEED**

On March 14, 2004, we entered into a Consent and Amendment Agreement with BayStar to amend certain provisions of our Registration Rights Agreement covering the registration of the Common Stock issuable upon conversion of our Series B Preferred Stock and the Common Stock issuable upon exercise of BayStar's warrants (collectively the "Registrable Securities"). Under this agreement, in exchange for a cash payment of \$200,000 made on April 1, 2004 and issuance of 500,000 shares of our common stock with a value of approximately \$952,000 (based on the average closing bid price of our common stock for the five trading days preceding the issuance), BayStar agreed to extend the deadline by which our Registration Statement must be declared effective by the Securities and Exchange Commission by 90 days (to July 2, 2004). In addition, in exchange for such consideration, BayStar has agreed to waive the \$5,000 per day penalties accrued thus far and up to and including July 2, 2004. We issued our Common Stock in reliance upon the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended, and Regulation D promulgated thereunder.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.



## ITEM 5. OTHER INFORMATION

None.

## ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

### (a) Exhibit Index

<b>Exhibit Number</b>	<b>Description</b>
3.1(1)	Amended and Restated Certificate of Incorporation of Commerce One, Inc.
3.2(2)	Certificate of Amendment, dated September 16, 2002, to Certificate of Incorporation.
3.3*	Amended and Restated Bylaws of Commerce One, Inc.
4.1(1)	Specimen Common Stock Certificate.
4.2(4)	Amended and Restated Preferred Stock Rights Agreement, dated as of December 31, 2003, between Commerce One, Inc. and Equiserve Trust Company, NA.
4.3(3)	Certificate of Designations, Preferences and Rights of the Series B Convertible Preferred Stock.
10.1(5)	Consent and Amendment Agreement, dated March 14, 2004, by and between Commerce One, Inc. and BayStar Capital II, L.P.
10.2(5)	Registration Rights Agreement, dated March 14, 2004, by and between Commerce One, Inc. and BayStar Capital II, L.P.
31.1	Certifications of the Chief Executive Officer and Chief Financial Officer of Commerce One pursuant to section 302 of the Sarbanes Oxley Act.
32.1	Certification of the Chief Executive Officer and Chief Financial Officer of Commerce One pursuant to section 906 of the Sarbanes Oxley Act.

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|-----|---|
| (1) | Incorporated by reference to Commerce One's Form 8-A filed on July 11, 2001.      |
| (2) | Incorporated by reference to Commerce One's Form 8-K filed on September 19, 2002. |
| (3) | Incorporated by reference to Commerce One's Form 8-K filed on July 11, 2003.      |
| (4) | Incorporated by reference to Commerce One's Form 10-Q filed on August 14, 2003.   |
| (5) | Incorporated by reference to Commerce One's Form 8-K filed on March 16, 2004.     |

\* Previously filed.

### (b) Reports on Form 8-K filed during the quarter ending March 31, 2004.

<b>Filing Date</b>	<b>Event Reported</b>
January 6, 2004	A report on Form 8-K filed by Commerce One, Inc. disclosing that the we had entered into a Settlement Agreement with Covisint, LLC pursuant to which Covisint paid us the sum of \$4,650,000.
January 8, 2004	A report on Form 8-K filed by Commerce One, Inc. disclosing that we issued secured promissory notes in the aggregate principal amount of \$5.0 million and warrants to purchase 2,568,494 shares our common stock to ComVest Investment Partners II and DCC Ventures for an aggregate purchase price of \$5,000,100.
January 13, 2004	A report on Form 8-K furnished by Commerce One, Inc. disclosing that we had issued a press release announcing preliminary results for the quarter ended December 31, 2003 and updating our cash position.
February 5, 2004	A report on Form 8-K filed by Commerce One, Inc. furnishing our financial results for the fourth quarter and the fiscal year ended December 31, 2003, and announcing that we would amend our financial statements to reclassify warrants issued in connection with our Series B Preferred Stock financing in July 2003.
March 1, 2004	A report on Form 8-K filed by Commerce One, Inc. announcing a number of executive-level personnel changes.
March 16, 2004	A report on Form 8-K filed by Commerce One, Inc. disclosing that the we had entered into a Consent and Amendment Agreement with the holder of our Series B Preferred Stock extending the

deadline by which we must have our Registration Statement on Form S-3 (File No. 333-108144) registering the resale of the shares of our common stock underlying our Series B Preferred Stock and associated warrants declared effective by the Securities and Exchange Commission.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

COMMERCE ONE, INC.

*(Registrant)*

Dated: June 3, 2004

By: /s/ Charles D. Boynton  
*Senior Vice President and Chief Financial  
Officer (Principal Financial and Accounting  
Officer)*

Dated: June 3, 2004

By: /s/ Mark B. Hoffman  
*President, Chief Executive Officer and Chairman  
of the Board (Principal Executive Officer)*

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\* Previously filed.