MICHAEL A. PIAZZA, Cal. Bar No. 235881
Email: piazzam@sec.gov
MICHELE WEIN LAYNE, Cal. Bar No. 118395
Email: laynem@sec.gov
MOLLY WHITE, Cal. Bar No. 171448
Email: whitem@sec.gov
ALKA N. PATEL, Cal. Bar No. 175505
Email: patelal@sec.gov
JESSICA RIGLEY MARREN, Cal. Bar No. 208074
Email: marrenj@sec.gov

Attorneys for Plaintiff
Securities and Exchange Commission
Randall R. Lee, Regional Director
Sandra J. Harris, Associate Regional Director
5670 Wilshire Boulevard, 11th Floor
Los Angeles, California 90036
Telephone: (323) 965-3998
Facsimile: (323) 965-3908

UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, vs. STUART H. WOLFF and PETER B. TAFEEN, Defendants.	Case No. **COMPLAINT FOR VIOLATIONS OF THE FEDERAL SECURITIES LAWS**

Plaintiff Securities and Exchange Commission ("Commission") alleges as follows:

JURISDICTION AND VENUE

1. The Court has jurisdiction over this action pursuant to Sections 20(b), 20(d)(1), and 22(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §§ 77t(b), 77t(d)(1), and 77v(a) and Sections 21(d)(3)(A), 21(e), and 27 of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. §§ 78u(d)(3)(A),

78u(e), and 78aa. Defendants have, directly or indirectly, made use of the means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange, in connection with the transactions, acts, practices, and courses of business alleged in this Complaint.

2. Venue is proper in this district pursuant to Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), and Section 27 of the Exchange Act, 15 U.S.C. § 78aa, because certain of the transactions, acts, practices, and courses of conduct constituting violations of the federal securities laws occurred within this district.

SUMMARY

3. This action concerns a financial fraud perpetrated on the investing public by the management of Homestore, Inc. ("Homestore" or the "Company"), including defendants Stuart Wolff, its former chief executive officer and chairman of the board of directors, and Peter Tafeen, its former executive vice president of business development. At the time of the alleged violations, Homestore was an Internet portal for real estate and related services based in Westlake Village, California.

4. From at least the third quarter of 2000 through November 2001, Wolff and Tafeen, along with other officers and employees of Homestore, engaged in a fraudulent scheme to misstate the Company's operating results by overstating advertising and subscription revenues. In the face of the demise of many dot-com companies and a market demanding steady growth in revenues, Wolff, Tafeen, and the other Homestore officers and employees fraudulently inflated the Company's revenues to exceed Wall Street analysts' expectations. The scheme involved a complex structure of "round-trip" transactions using various third party companies for the sole purpose of generating advertising revenues for Homestore. The essence of these transactions was a circular flow of money by which Homestore recognized its own cash as revenue. Specifically, Homestore paid inflated sums to various vendors for services or products, and, in turn, the vendors used these funds

to buy advertising from two media companies. The media companies then bought advertising from Homestore either on their own behalf or as agents for other advertisers. Homestore recorded the money received from the sale of such advertising as revenue in its financial statements, materially inflating its revenue for the relevant periods, and violating applicable accounting principles.

5. Defendants Wolff and Tafeen knew that the round-trip transactions had no economic substance and that recognizing revenue from these transactions was improper. Specifically, they knew that Homestore paid large sums of cash to numerous third parties for the primary purpose of selling advertising and recognizing revenue from these or related transactions. The defendants facilitated this arrangement and recorded, or caused to be recorded, revenue on the round-trip deals. Moreover, Wolff concealed the existence of the round-trip transactions from Homestore's shareholders, analysts, and auditors, PricewaterhouseCoopers ("PwC"), through misleading public filings, press releases, and management representation letters. Tafeen single-handedly negotiated and executed several transactions that he knew were improper and withheld their true nature from Homestore's finance department and PwC.

6. As part of the fraudulent scheme, Homestore filed Forms 10-Q with the Commission that contained financial statements with materially inflated revenue for the quarters ended September 30, 2000, March 31, 2001, June 30, 2001, and September 30, 2001 as well as press releases on September 6, 2001 and October 3, 2001 that did not accurately reflect Homestore's financial condition or the existence of the round-trip transactions.

7. After the scheme was uncovered, the Company issued corrected financial statements for these quarters that sharply reduced the previously reported revenues. Homestore admitted that it had overstated total revenues in its first three quarterly financial statements for 2001 by $119 million (51%) and in its third quarter financial statements for 2000 by $1.5 million (5%).

8. While the fraud was ongoing, defendants Wolff and Tafeen exercised stock options, reaping profits of approximately $11 million and $7.8 million, respectively. At the same time, they also earned significant salaries and, in Tafeen's case, cash bonuses.

THE DEFENDANTS

9. Stuart Wolff, age 42, is a resident of Westlake Village, California. He was Homestore's chief executive officer and chairman of the board from 1997 until January 2002, when Homestore terminated his employment.

10. Peter Tafeen, age 36, is a resident of Parkland, Florida. He was Homestore's executive vice president of business development from 1997 through November 2001. During his tenure, Tafeen reported to Wolff and was responsible for the strategic alliances group ("SAG") and business development group.

THE FRAUDULENT SCHEME

A. Background

11. Homestore, Inc., previously known as Homestore.com, Inc., was one of the top portals for online real estate and related services in 2001. Homestore provided Internet real estate listings to consumers on Realtor.com and also marketed services and products to real estate brokers. At all relevant times, the Company's stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act and traded on the Nasdaq National Market.

12. Generally accepted accounting principles ("GAAP") do not permit companies to recognize revenue on transactions without any economic substance, such as the round-trip transactions described above. Further, GAAP requires that barter revenue (that is, revenue obtained from the exchange of services) be recorded based on the fair value of the assets or services exchanged. For barter transactions involving an exchange of advertising, the fair value must be based on similar cash transactions of the company within the prior six-month period. Additionally, under GAAP, a company must disclose that it has engaged in barter

transactions in its financial statements.

13. To sell its common stock and other securities to members of the public and maintain public trading of its securities, Homestore was required to comply with statutes, rules, and regulations designed to ensure that the Company's financial information was accurately recorded and disclosed to the investing public. Under these statutes, rules, and regulations, Homestore had a duty to, among other things, (a) make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflected its transactions and dispositions of assets; (b) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP or any other criteria applicable to such statements and to maintain accountability for assets; and (c) file with the Commission quarterly reports on Forms 10-Q for each of the first three quarters of each fiscal year including financial statements that disclose the Company's financial condition and results of business operations for each three-month period.

14. Throughout 2000 and 2001, Homestore had two primary sources of revenue. It generated approximately 60% of its revenue from the sale of subscriptions, products, and services to real estate agents. Homestore derived the remaining 40% of its revenue from the sale of online advertisements that appeared on the Company's website. Because advertising revenue was one of the key components of Homestore's overall financial results, the Company separately disclosed that revenue in its financial statements.

15. Homestore entered into several unconventional two-party transactions in 2000 and early 2001. Through these deals, Homestore bought online advertising or some service or right (such the ability to operate a co-branded website) from a vendor. On the same day, or immediately thereafter, that vendor bought online advertising from Homestore in roughly the same dollar amount as Homestore's

purchase from the vendor. Homestore recorded this amount as advertising revenue.

16. Homestore's finance staff disclosed the existence of the two-party transactions to PwC to determine whether Homestore could properly recognize revenue from the sale of the online advertising. PwC scrutinized these deals and determined that in circumstances involving non-monetary exchanges (i.e., transactions in which no cash was exchanged), the transactions should be characterized as "barter." To properly recognize revenue for barter deals under GAAP, Homestore provided PwC with considerable documentation supporting the position that these were legitimate, arm's-length transactions entered into at market prices for the advertising or services exchanged. Also, Homestore was required to disclose in its financial statements how much of its advertising revenue came from barter (as opposed to cash) deals.

17. Homestore personnel engaged in vigorous discussions with PwC to justify the legitimacy of fully recognizing this barter revenue on a gross basis. In early 2001, however, PwC determined that Homestore could not recognize gross revenue from several two-party deals because new accounting guidance required these deals to be recorded on a net basis. PwC disagreed with Homestore's finance department as to whether the company had appropriate support for the transactions in order to comply with GAAP. In light of PwC's objections, Homestore's finance executives agreed not to recognize revenue from the challenged transactions. PwC's increased scrutiny of the two-party transactions and conservative approach to revenue recognition prompted Homestore management, specifically Tafeen, to develop a scheme to engage in round-trip transactions involving more than two parties in order to mislead PwC and thereby to inflate revenues to meet analysts' expectations.

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B. The Fraudulent Gateway Deal in the Third Quarter of 2000

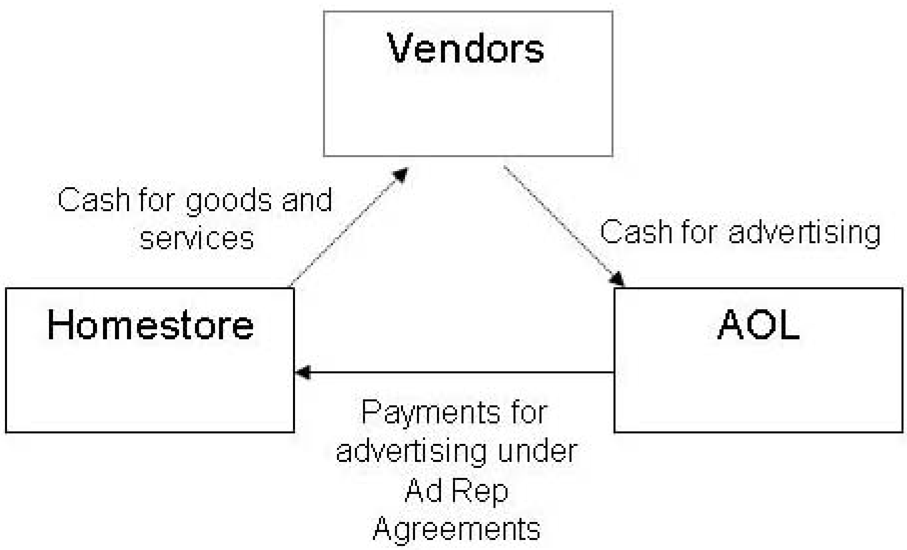
18. Facing a revenue shortfall in the third quarter of 2000, and even before PwC began strictly scrutinizing Homestore's two-party deals, Tafeen negotiated Homestore's first three-party round-trip transaction, which involved AOL Time Warner, Inc. ("AOL") and Gateway, Inc. ("Gateway"). Gateway was obligated to purchase certain advertising from AOL based on a pre-existing contract. Tafeen negotiated the deal such that Homestore would pay AOL $1.5 million for advertising in exchange for Gateway spending the same amount on advertising with Homestore. Essentially, Homestore paid AOL, AOL paid Gateway, and Gateway paid Homestore, all in approximately the same amounts. Tafeen negotiated, executed, and implemented this transaction without informing Homestore's finance department of its true nature.

19. Tafeen single handedly negotiated and executed the deal and ensured that its true nature was withheld from the finance department. As a result, Homestore successfully met its third quarter revenue target by improperly recognizing $1.5 million in advertising revenue and overstating its advertising revenue by 5%. Tafeen understood that his efforts resulted in Homestore recording advertising revenue and that the Gateway transaction was necessary for Homestore to meet its revenue expectations for the quarter.

C. The Fraudulent Round-trip Transactions with AOL in 2001

20. The online advertising market began to slow down in late 2000, and by the first quarter of 2001, Homestore faced a projected $15 million shortfall in advertising revenue. Homestore executives were desperate to meet analysts' expectations and internal sales targets and, at Tafeen's urging, began relying on three-party round-trip transactions as a continuing revenue source. These deals enabled Wolff, Tafeen and Homestore to circumvent PwC's increased scrutiny and improperly inflate revenue by allowing the company to funnel its own money through various outside parties and recognize it as advertising revenue.

21. In late March 2001, Tafeen facilitated an agreement between Homestore and AOL to engage in round-trip transactions to generate advertising revenue at Homestore. Homestore and AOL agreed to enter into transactions whereby Homestore "referred" companies to AOL to purchase online advertising at AOL. In return – and after retaining a fee of several million dollars – AOL agreed to purchase online advertising from Homestore in the name of several companies for which AOL acted as a media buyer. The amount of AOL's advertising purchases from Homestore depended on the amount of advertising purchased through Homestore's referrals. The following diagram generally illustrates the structure of these transactions, which occurred in the first, second, and third quarters of 2001:



1. <u>First Leg of the Transaction</u>

22. To begin the flow of cash, Homestore purchased services and products (such as software licenses or marketing rights) from various vendors. In the first and second quarters of 2001, Homestore paid $16.3 million and $33.4 million, respectively, to a total of 16 different vendors for the purpose of executing the round-trip transactions.

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23. Homestore generally had no business need to enter into these deals. Homestore paid inflated amounts for the services and products and then improperly justified these amounts as “fair market value.” In all instances, Homestore paid the vendors the entire purchase price at the beginning of the deal while agreeing to receive the goods or services over a period ranging from two to five years. As an unwritten condition of these transactions, Homestore required the vendors to buy online advertisements from AOL with most or all of the money that the vendor received from Homestore.

24. In its financial statements, Homestore capitalized the purchase price to the vendors as prepaid assets and amortized them over the terms of each agreement. In other words, Homestore did not record an up-front expense in the amount of the purchase, but rather recorded the expense on a pro rata basis over the life of the agreement. This effectively reduced current expenses on Homestore’s income statement, thereby increasing net earnings. Thus, Homestore successfully deferred recognizing the expenses of the purchases despite the immediate cash outlay.

2. <u>Second Leg of the Transaction</u>

25. The vendors used most, if not all, of the funds they received from Homestore to purchase advertising from AOL. In the first and second quarters of 2001, the 16 vendors cumulatively bought advertising from AOL in the amounts of $15.8 million and $29.2 million, respectively. Beginning in the second quarter of 2001, AOL agreed to pay Homestore a 5% fee for Homestore’s “referral” of vendors to AOL.

26. Homestore employees and management, including defendants, intentionally concealed this second leg of the round-trip transaction from the auditors. To avoid arousing any suspicion from its auditors, Homestore did not even record approximately $1.4 million in “referral” revenue that it received from AOL in the second quarter of 2001.

3. Third Leg of the Transaction

27. After obtaining the funds from the vendors, AOL purchased a significant amount of Homestore advertising in 2001 as a media buyer for other non-vendor companies. This amounted to approximately $40 million during the first three quarters of 2001.

D. The Fraudulent Round-Trip Transactions with L90

28. In the second and third quarters of 2001, Homestore engaged in similar round-trip transactions with MaxWorldwide, Inc., formerly known as L90, Inc. ("L90"). Like the AOL deals, the transactions with L90 had no economic substance and were executed solely to inflate advertising revenues.

29. In the second quarter of 2001, Homestore paid $4.55 million to a vendor to acquire on-line marketing data. The vendor then transferred most of this money to L90 in exchange for advertising. Simultaneously, L90, either for itself or its subsidiary, purchased $4 million of on-line advertising from Homestore. Homestore recorded this amount as revenue and reported it in its financial statements included within its second quarter 2001 Form 10-Q.

30. Similarly, in the third quarter of 2001, Homestore entered into another round-trip deal with L90. In September 2001, Homestore paid approximately $5.7 million to a different vendor. After circulating the money to various conduit entities of the vendor, it was eventually transferred to L90. Thereafter, L90 and/or its subsidiary bought $5.65 million in advertising from Homestore. Again, Homestore recorded this purchase as advertising revenue and reported it in its financial statements included within its third quarter 2001 Form 10-Q.

31. Homestore concealed the true nature of the relationship between Homestore's payment to these vendors and the revenue generated from the sale of advertising to L90 from PwC.

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E. <u>Homestore Reports Inflated Advertising Revenue</u>

32. In the first two quarters of 2001, Homestore paid a total of $49.8 million to various vendors to facilitate the AOL round-trip deals. These vendors then collectively paid $45.1 million to AOL to purchase online advertisements. Homestore, in turn, recorded $36.7 million in revenue that it received from AOL for the purchase of Homestore online advertisements. These transactions enabled Homestore to surpass the revenue estimates of securities analysts covering Homestore in the first two quarters of 2001.

33. Homestore reported cash received from AOL, as well as Gateway and L90, as advertising revenue in its financial statements contained in its periodic reports filed with the Commission. This accounting treatment was incorrect because Homestore should not have recognized any revenue from these round-trip sales under GAAP. These deceptive and complicated transactions were designed to fool PwC and artificially inflate Homestore's revenue.

34. Homestore, through the efforts of Wolff, Tafeen, and others, fraudulently recognized as advertising revenue the money it received from the round-trip transactions and falsely reported the revenue in its financial statements contained within its Forms 10-Q filed with the Commission for the third quarter of 2000 and the first three quarters of 2001, as well as in an October 2001 registration statement on Form S-8. Homestore overstated advertising revenue related to the third quarter 2000 Gateway round-trip transaction by 5% and total revenue by 2.4%, which allowed Homestore to meet its revenue target for the quarter. Homestore also overstated advertising revenue related to AOL and L90 by 46 to 80% and its total revenue by 8 to 21% in the first three quarters of 2001.

35. Additionally, despite specific questions regarding Homestore's key advertisers, the company never disclosed its relationships with AOL or L90 in conference calls with analysts or in its quarterly filings. The following chart demonstrates the significance of the false advertising revenue to Homestore's

financial statements:

	Revenue Homestore Reported from the Gateway Deal	Revenue Homestore Reported from the AOL Deals	Revenue Homestore Reported from the L90 Deal	Homestore's Reported Advertising Revenue	% Bogus	% Over-stated	Homestore's Reported Total Revenue	% Bogus	% Over-stated
Q3 2000 10-Q	$1,500,000	$0	$0	$29,500,000	5%	5%	$62,200,000	2.4%	2.4%
Q1 2001 10-Q	$0	$15,000,000	$0	$40,119,000	37%	60%	$105,491,000	14%	16%
Q2 2001 10-Q	$0	$18,445,000	$4,000,000	$50,615,000	44%	80%	$129,283,000	17%	21%
Q3 2001 10-Q	$0	$3,315,000	$5,650,000	$28,574,000	31%	46%	$116,135,000	8%	8%
Total for 2001	$0	$36,760,000	$9,650,000	$119,308,000	39%	64%	$350,909,000	13%	15%

F. <u>Homestore Reports Inflated Subscription Revenue</u>

36. In addition to its inflation of advertising revenue, Homestore also reported inflated subscription revenue by exploiting a close business relationship it had with Cendant Corporation. Cendant is a public company headquartered in New York, New York that was focused on providing travel and real estate services while operating in five business segments. The Real Estate Services segment franchised Cendant's real estate brokerage businesses and was the segment that had involvement with Homestore.

37. In the first quarter of 2001, Homestore acquired Move.com, Cendant Corporation's online Internet portal, for approximately $750 million in cash and stock. As a result, Cendant held about 20% of Homestore's stock and obtained a seat on Homestore's board. As a component of that acquisition deal, Cendant's Real Estate Technology Trust ("RETT"), a subsidiary that operated as an independent trust dedicated to acquiring technology for the benefit of Cendant's real estate brokers, agreed to purchase $80 million in Homestore products and software. These purchases were attributed to Homestore's subscription revenue, which included sales from Homestore's real estate services group and retail and consumer services group.

38. Homestore engaged in round-trip transactions with Cendant in the second and third quarters of 2001. These round-trip deals involved the RETT purchasing software from Homestore in exchange for Homestore agreeing to spend an equal amount of money with Cendant in the future. Tafeen negotiated and executed these transactions on behalf of Homestore, despite warnings from the finance department that such deals would receive increased scrutiny from PwC and would most likely be "netted."

39. The two Cendant transactions resulted in the improper overstatement of subscription revenues by $15 million or 10%. This inflated subscription revenue was reported in Homestore's Forms 10-Q filed with the Commission for the second and third quarters of 2001. Revenue from the second quarter deal was included in Homestore's October 2001 registration statement on Form S-8.

G. <u>Homestore Exceeds Wall Street Expectations Using Round-Trip Deals</u>

40. As demonstrated below, the fraudulent transactions with AOL, Gateway, L90, and Cendant enabled Homestore to meet and exceed Wall Street analysts' expectations during each of the relevant periods except for the third quarter of 2001. The table below shows the consensus revenue numbers derived from the analysts who covered Homestore.

	Analysts' Expectations For Gross Revenues *(In Millions)*		Reported Gross Revenues *(In Millions)*
Q3 2000	55.1		62.2
Q4 2000	68.4		79.0
Q1 2001	106.6		118.4*
Q2 2001	122.1		129.3
Q3 2001	127.4		116.1
			* Q1 2001 Reported Revenues include the impact of a mid-quarter acquisition as if it occurred as of 1/1/01.

H. Homestore Misrepresents Its Financial Condition to Analysts and in Press Releases in the Third Quarter of 2001

41. In the third quarter of 2001, Homestore faced a $20 million revenue shortfall and was on the verge of missing its earnings target for the first time. Although Homestore had replaced AOL with L90 as a participant in the round-trip transactions, those transactions were smaller and could not make up for the $20 million deficit. Homestore executives, including Wolff and Tafeen, decided to remedy the deficit by using a strategy to acquire other profitable companies. Due to Homestore's depressed stock price, it could only use cash for the acquisitions. Homestore planned to raise the cash through a convertible bond offering.

42. By early September 2001, however, Homestore abandoned the offering because of poor market conditions and Homestore's stock price. Despite aggressive efforts, Homestore executives, including Wolff, knew that the necessary acquisitions could not be completed and that Homestore would not overcome the revenue shortfall in the third quarter of 2001. Additionally, negotiations with acquisition targets were at a preliminary phase, making it clear to management that Homestore would not be able to conclude the acquisitions within the third quarter and would therefore miss its third quarter revenue target.

1. Homestore's Improper Reaffirmation of Guidance in the Third Quarter of 2001

43. Despite its growing revenue shortfall, Homestore, at Wolff's direction, issued a press release on September 6, 2001 stating that it intended to meet its previously reported revenue and earnings goals for the third quarter of 2001. The September 6, 2001 press release reaffirmed Homestore's revenue guidance of $134 million and proforma earnings per share of $0.16. The press release shocked some Homestore executives, who were aware of the company's financial crisis and the lack of new revenue deals.

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2. Homestore's Misrepresentations Regarding Its Failure to Meet Third Quarter 2001 Revenue Estimates

44. After failing to meet the revenue estimates as reaffirmed in the September 6, 2001 press release, Homestore management misrepresented the reasons for the shortfall. In an October 3, 2001 press release and in a November 1, 2001 analysts' conference call, Wolff used the September 11, 2001 tragedy as an excuse for Homestore's inability to meet revenue expectations. Homestore's October 3, 2001 press release stated that its business was impacted by the "Sept. 11 terrorist attacks and the advertising market slowdown." Wolff reiterated these misrepresentations in the November 1, 2001 call, even though he knew that the true reason Homestore was unable to meet the revenue estimates was primarily because of fewer round-trip deals and the overall slow-down in Internet advertising.

I. Wolff's Role in Homestore's Fraudulent Scheme

45. As the CEO and chairman of the board, Wolff was the most senior officer at Homestore. He sanctioned Homestore's fraudulent scheme to inflate revenue, including the withholding of key information from PwC. Further, Wolff misrepresented Homestore's financial results and other crucial information in public filings, conference calls, and press releases. Despite his knowledge of Homestore's financial crisis and its reliance on improper round-trip transactions to meet revenue goals, he failed to halt or disclose the scheme, participated in concealing it from the auditors, and persisted in portraying Homestore as a vibrant and profitable company in an effort to meet or exceed Wall Street's estimates.

1. Wolff Knew About the Round-Trip Transactions and That They Were Not Fully Disclosed to PwC

46. Wolff fully understood the true nature of the round-trip structure of the AOL and L90 transactions. Wolff had specific conversations with Joseph Shew, Homestore's former chief financial officer, and John Giesecke, Homestore's

former chief operating officer, in which they discussed that the triangular nature of the round-trip deals was being concealed from PwC. For example, in an executive meeting session at the Calamigos Ranch in May 2001 ("Calamigos Meeting"), Wolff and Tafeen met privately with Giesecke and Shew to discuss Homestore's second quarter revenue prospects.

47. In that meeting, Shew distributed internal reports, known as Risks and Opportunities Reports ("R&O Reports"), which reflected a $20 to 30 million revenue shortfall for the second quarter of 2001. After discussing alternatives for making up the shortfall, the four executives agreed that another round-trip transaction with AOL was necessary. Shew described the triangular nature of the AOL transaction and informed Wolff and Tafeen that if PwC knew about the full structure, PwC would not allow Homestore to recognize revenue on the deals.

48. At a lunch meeting in April 2001, Shew expressed to Wolff his discomfort in dealing with PwC on the round-trip deals. Wolff assured Shew that the AOL deal was necessary until Homestore was acquired or the economy improved.

49. In a similar conversation in July 2001, Shew, in tears, expressed his frustration that the round-trip transactions were ongoing, notwithstanding Wolff's initial assurance that they were temporary. Shew told Wolff that "it was his team that had to look PwC in the eye and lie" and that he could not tolerate it any longer. Wolff consoled Shew; however, he never told Shew that he intended to discontinue the round-trip deals.

50. Separately, Giesecke told Wolff that PwC was questioning the round-trip deals and that Shew was having trouble justifying the aspects of the deal that Homestore was actually disclosing to PwC.

51. Wolff also participated in discussions with AOL regarding certain aspects of the round-trip transactions. Specifically, in the second quarter of 2001, AOL refused to pay Homestore for some of the advertising because some vendors

in the round-trip transaction had not yet paid AOL. Because AOL would not pay Homestore, Homestore was unable to recognize certain advertising revenue from the AOL round-trip transaction. Wolff wanted AOL to pay Homestore regardless of whether or not the vendors paid AOL. Wolff engaged in various discussions with executives at AOL regarding this issue, which necessarily required an understanding of the improper nature of the deal.

52. Homestore management periodically apprised Wolff of the Company's financial position through meetings in which the R&O Reports were discussed at length. These reports listed the various potential revenue deals (including round-trip transactions) for the respective quarter, compared them with the analysts' expectations for that quarter, and identified the revenue shortfall that would need to be filled by other deals. Accordingly, it was clear to Wolff that the revenue from the round-trip deals (a) was improperly recognized because Homestore was concealing information from PwC; and (b) contributed to the quarterly revenue that was included in the company's financials and reported to Wall Street analysts.

53. Despite Wolff's knowledge of the circular nature of the round-trip deals and that their true nature was concealed from PwC, he signed management representation letters dated May 30, 2001 and August 9, 2001 to PwC which falsely stated that (a) the company had made available to PwC all financial records and related data; (b) the financial statements included all necessary disclosures; (c) there were no material transactions, agreements, or accounts that had not been properly recorded in the financial statements; and (d) there had been no fraud that could have a material effect on the financial statements. When Wolff signed the letters, he knew that these representations were false because he was aware of and involved in the scheme to withhold information from PwC. Shew and Giesecke had informed him that revenue recognition would not be possible on the round-trip deals if PwC knew about the entire transaction. Additionally, Wolff knew that

PwC relied on the representations for the purpose of issuing the independent audit report.

2. <u>Wolff Misrepresented Homestore's Financial Results in Press Releases and Analysts' Conference Calls, and Failed to Disclose the Round-Trip Transactions</u>

54. Wolff also misled the public about Homestore's financial condition. Specifically, when asked about the nature of Homestore's advertisers, Wolff told analysts that the advertising revenue came from "brick and mortar" companies and that the company did not break out the individual advertisers. Wolff knew, however, that Homestore was generating the appearance of advertising revenue by circulating its own money through small, dot-com companies.

55. Wolff further misled Homestore investors by failing to give an accurate picture of the Company's financial position and revenue trend in Homestore's public filings, press releases, and analyst conference calls. He also failed to disclose that Homestore was meeting revenue expectations through the use of round-trip transactions in Homestore's Forms 10-Q for the first three quarters of 2001 that he reviewed and signed. Specifically, Wolff took no steps to disclose this important trend – that he knew could not be sustained – in the Management's Discussion and Analysis section ("MD&A") of Homestore's periodic filings.

56. Additionally, Wolff misrepresented facts in press releases and in conversations with stock analysts when Homestore was facing acute financial problems in the third quarter of 2001. He persisted in reaffirming revenue guidance for the third quarter even though (a) he knew that the possibility of meeting those revenue estimates was remote; and (b) Shew and Giesecke recommended lowering the revenue guidance for the third quarter of 2001.

57. During the quarter, Homestore management, including Wolff, discussed the R&O Reports and the expected revenue shortfall of approximately

$20 million. Wolff knew that the company's "acquisition strategy" was intended to be the revenue source in place of other advertising deals. He also knew these acquisitions would be financed by the convertible bond offering which, in turn, required that the stock price be maintained. Wolff knew that the due diligence on many of the acquisition targets was far from complete, but Wolff told Shew not to give any details about this to the investment bankers associated with the bond offering.

58. After the end of the quarter, when it became clear that Homestore had missed its revenue target, Wolff blamed the shortfall on the September 11, 2001 tragedy. In fact, Wolff began to strategize about using the tragedy as an excuse for Homestore missing its estimates just one day after the terrorist attacks. Wolff falsely invoked the September 11, 2001 tragedy in an October 3, 2001 press release and in the November 1, 2001 analysts' conference call.

59. During the call, some analysts expressed skepticism about Wolff's explanation regarding the impact of the tragedy, particularly because the tragedy occurred so close to the quarter-end. They questioned Wolff why the last nineteen days of the quarter made such a major impact on the quarter's financial results. Despite being pressed, Wolff dodged the questions and ultimately refused to give a satisfactory explanation. In fact, Wolff knew about the Company's consistent revenue decline and its overall inability to meet revenue estimates due to Homestore's inability to continue its round-trip transactions with AOL, as well as the general slow down in the online advertising market.

J. <u>Tafeen's Role in Homestore's Fraudulent Scheme</u>

60. As the EVP of business development, Tafeen was Wolff's second-in-command and was chiefly responsible for bringing in nearly all of Homestore's revenue. Tafeen constantly battled Homestore's finance personnel in order to recognize revenue on deals that raised questions from PwC. In late 2000, Tafeen learned about the three-party round trip structure from his counterpart at AOL.

When faced with Homestore's $15 million revenue shortfall in the first quarter of 2001, Tafeen directed his team to utilize the fraudulent round-trip structure as a means by which to inflate revenue and meet analyst expectations. Tafeen was intimately involved in the negotiation and implementation of the round-trip transactions and understood that their true nature was concealed from PwC. In efforts to circumvent Homestore's accounting controls and recognize even more revenue, Tafeen also concealed the true nature of several deals from Homestore's own finance department.

1. <u>Tafeen Executes the Gateway Deal</u>

61. In September 2000, Tafeen worked directly with executives at AOL to execute a round-trip transaction involving Homestore, AOL, and Gateway. As a result, Homestore improperly recorded $1.5 million in advertising revenue.

62. AOL and Gateway had an extensive and complicated relationship that required Gateway to purchase a fixed amount of advertising on AOL's various properties on a quarterly basis. Gateway was dissatisfied with the return from this arrangement and was in constant negotiations with AOL to improve the situation.

63. At the end of September 2000, AOL contacted Gateway and offered it the opportunity to advertise on Homestore's (rather than AOL's) website in exchange for reducing Gateway's commitment to AOL in the fourth quarter of 2000. Gateway agreed to the deal and agreed to purchase $1.5 million in advertising from Homestore. In return, Tafeen committed Homestore to purchase $1.5 million in advertising from AOL in the fourth quarter. AOL agreed to provide Gateway $1.5 million in cash so that Gateway could pay Homestore. Tafeen represented to AOL personnel that he was doing this deal because Homestore needed third quarter revenue.

64. Tafeen negotiated this round-trip transaction directly with AOL executives and participated in all aspects of the deal. He took steps to hide the round-trip nature of the transaction by not disclosing the entire transaction to

Homestore's finance department or to members of his own staff. Rather, Tafeen communicated directly with AOL personnel about the contract negotiation between Gateway and Homestore and about the invoice AOL sent Homestore. In fact, when the original invoice from AOL referenced Gateway, Tafeen demanded AOL personnel to remove the references. Further, Tafeen's personal assistant, rather than a finance representative, was charged with handling all collection issues that arose in the course of the deal.

65. Tafeen knew that the purpose of this transaction was to record revenue for Homestore and concealed the true nature of the transaction from those responsible for determining whether the transaction could be properly recorded. Tafeen understood that as a result of his efforts, Homestore improperly reported $1.5 million in advertising revenue in its financial statements contained within its Form 10-Q filed with the Commission for the third quarter of 2000.

2. <u>Tafeen Orchestrates the AOL Deals</u>

66. In the first quarter of 2001, Tafeen met privately with Shew to introduce Shew to the round-trip structure. Tafeen learned of the round-trip structure from his counterpart at AOL and intended to utilize it in order to overcome the revenue shortfall Homestore was facing. Tafeen explained to Shew that the transaction between AOL and the vendors would not be documented so that PwC would not know the circular nature of the deal. Tafeen understood that PwC had refused to allow Homestore to continue recognizing revenue on the two-way deals and that keeping documentation about the full transaction from PwC was essential so that Homestore could recognize revenue from these deals. At the end of the meeting, Tafeen told Shew that the round-trip structure was "so perfect it was scary." Shew did not opine on the legality of the round-trip structure.

67. Following his meeting with Shew, and without waiting for him to approve the round-trip structure, Tafeen implemented the deals by directing members of SAG and Business Development to begin restructuring two-way deals

into three-party round-trip transactions to be run through AOL. Tafeen also met with members of the finance group to explain the deal structure to them.

68. Tafeen then worked on the advertising representative agreement (the "Q1 Ad Rep Agreement") between Homestore and AOL, only a portion of which was in writing. This agreement authorized AOL to sell advertisements for Homestore's website to third parties. Under the Q1 Ad Rep Agreement, Homestore agreed to pay AOL a commission of 53% of the total value of the advertisements that AOL sold to other companies on behalf of Homestore. Tafeen ensured that the Q1 Ad Rep Agreement did not (a) document Homestore's corresponding obligation to refer advertisers to AOL in the first quarter of 2001; or (b) reference the method that AOL used to determine the amount of advertising it was to purchase from Homestore. Rather, these terms were informally agreed to by Tafeen and his counterpart at AOL.

69. In the second quarter of 2001, Tafeen knew that Homestore was facing another revenue shortfall. Consequently, Tafeen orchestrated another set of round-trip transactions with AOL designed to increase advertising revenues for both companies. After reaching an oral agreement on the parameters of the deal, however, AOL suspended Tafeen's counterpart at AOL, and Tafeen was forced to work with a different AOL executive. AOL agreed to another series of round-trip deals, but only on the condition that the companies document both sides of the deal, despite objections from Tafeen.

70. In early June 2001, AOL raised the idea of documenting Homestore's referral of advertisers to AOL in a letter ("Ad Referral Letter") to be attached to a new advertising representative agreement ("Q2 Ad Rep Agreement"). The Ad Referral Letter was to include a list of potential advertisers Homestore would refer to AOL. These essentially were the vendors from whom Homestore was purchasing goods and services to start the flow of money for the round-trip deal. The potential Ad Referral Letter was problematic to Homestore and caused

concern among senior management because documenting both sides of the deal increased the risk that PwC would detect the round-trip transactions. Tafeen and other Homestore executives discussed steps that Homestore could take to conceal the transactions if they were forced to incorporate the Ad Referral Letter. They distorted the list by adding several potential advertisers in an effort to prevent PwC from discovering the deals' round-trip structure. In addition, based on Shew's recommendation, Tafeen kept the percentage of the referral fee at just 5% so that Homestore would receive most of the revenue from AOL pursuant to the Q2 Ad Rep Agreement. Tafeen executed the agreement on behalf of Homestore.

71. Tafeen was continually informed about the round-trip deals and specifically the fact that SAG and Business Development personnel were taking steps to hide their round-trip nature from PwC. Homestore's former vice president of finance, John DeSimone, expressed concern about the concealment to Tafeen. He also explained to Tafeen that there could be no written side agreements and that vendors should appear to be unrelated to each other. Tafeen understood the relevant accounting rules and that the round-trip transactions were intended to "get around" the accounting requirements. He also understood, based on his review of the R&O reports, that the revenue from the round-trip deals was included in Homestore's financial statements that were reported to the Commission and used by Wall Street analysts.

72. Tafeen also knew that in previous quarters, PwC had raised concern about Homestore running a large volume of advertising in the last several days of the quarter. Tafeen understood that to address this concern, insertion orders were often backdated and that advertising was run on Homestore's site before finalizing an advertising deal. Tafeen knew that Homestore asked vendors to execute the AOL advertising purchase through a conduit entity so the vendor's name would not appear on the Ad Referral Letter. Tafeen also knew that the value of vendor deals was inflated, that Homestore usually had no business purpose for the

products and services purchased, and that the sole reason for the vendor deals was to start the flow of money for the round-trip deals.

73. Tafeen understood that due to his conduct, Homestore improperly reported over $30 million in advertising revenue that it received from AOL in its financial statements contained within its Forms 10-Q filed with the Commission for the first, second, and third quarters of 2001.

3. <u>Tafeen Engages in Fraudulent Transactions with Cendant</u>

74. During the May 2001 Calamigos Meeting, in addition to discussing the AOL deals, Tafeen, Wolff, Giesecke, and Shew also discussed a potential second quarter deal with Cendant. Because of Homestore's close relationship with Cendant, Tafeen felt that he could rely on Cendant for revenue if Homestore faced a shortfall. Tafeen said that Cendant would spend money at Homestore, but that it would require Homestore to spend money with Cendant in the future. Shew explained to Tafeen that PwC would strictly scrutinize deals with Cendant because of the close Homestore-Cendant relationship. He also stated that any deal with Cendant could not include a "give-back" because the deal would be "netted." Despite these explicit instructions from Shew, Tafeen executed round-trip deals with Cendant in the second and third quarters of 2001. Tafeen did not disclose Homestore's future obligation to spend money with Cendant to PwC, Shew, or anyone else in the finance department.

75. In June 2001, Tafeen orchestrated a deal for Cendant's RETT to purchase $6 million of Homestore products in exchange for Homestore agreeing to enter into a written "preferred alliance agreement" ("PAA") with Cendant for the same amount of money. Tafeen agreed to this even though he understood from Shew that Homestore could not properly recognize revenue on the deal if it entered into a contemporaneous agreement to spend money with Cendant in the future. As a result, when Tafeen negotiated the PAA with Cendant, he asked Cendant to post-date the contract to January 2002 for "revenue recognition purposes." Cendant

eventually agreed to date the PAA "as of" July 2001. Tafeen executed the PAA and never disclosed its existence to anyone in Homestore's finance department, even though former finance manager Jeffrey Kalina directly asked Tafeen whether there was any "give-back" associated with the transaction.

76. Tafeen understood that his efforts resulted in Homestore improperly reporting $6 million in subscription revenue from the RETT purchase in its financial statements contained within the second quarter 2001 Form 10-Q filed with the Commission.

77. In September 2001, Tafeen again contacted Cendant looking for additional revenue. At Tafeen's request, Cendant agreed that the RETT would purchase $9 million in Homestore products in exchange for Homestore executing PAAs in an equal amount. Before the deals could be finalized, Tafeen left Southern California and moved to Florida. The deal was essentially complete when Tafeen left; however, he asked Kalina to finalize the deal and gave Kalina the second quarter PAA for reference.

78. When Kalina saw the signed second quarter PAA, he realized that the third quarter PAAs involved a contemporaneously executed "give-back" and brought them to Shew's attention. Shew and Kalina were troubled by the second quarter PAA, but did nothing to challenge it. They did, however, contact Tafeen, confront him about the second quarter PAA, and told him that he could not sign the third quarter PAAs in their current form. Tafeen responded, "You told me not to tell you when I did these things." Shew reiterated to Tafeen that there could be no "give-back" to Cendant and told Kalina to work with a Homestore lawyer to finalize the deal without a contemporaneous obligation.

79. Kalina and the Homestore lawyer amended the third quarter PAAs so that they had an "effective date" of January 2002. They sent the revised third quarter PAAs to Cendant, but Cendant refused to agree to the changes. The Cendant executive involved told Kalina that he would talk directly to Tafeen about

the agreements and that the RETT would not send signed purchase agreements for $9 million in Homestore products if January 2002 were the effective date in the PAAs between Cendant and Homestore. Kalina contacted Tafeen again and told him that in order for the deal between the RETT and Homestore to pass muster with PwC, the terms of the PAA had to change. Kalina also told Tafeen that Tafeen could not sign the version of the PAAs he had negotiated. Tafeen promised not to sign his version of the agreements. Later that day, Kalina received the purchase agreements from the RETT and Homestore improperly recognized $9 million in subscription revenue.

80. Tafeen understood that his efforts resulted in Homestore improperly reporting $9 million in subscription revenue from the RETT purchase in its financial statements contained within the third quarter 2001 Form 10-Q filed with the Commission.

81. No one from Homestore's finance department knew that Tafeen had executed the third quarter PAAs until November 2001, when Cendant's CFO contacted Shew asking for payment.

FIRST CLAIM FOR RELIEF

FRAUD IN THE OFFER OR SALE OF SECURITIES

Violations of Section 17(a) of the Securities Act

(Against Wolff and Tafeen)

82. The Commission realleges and incorporates by reference ¶¶ 1 through 81 above.

83. Defendants Wolff and Tafeen, by engaging in the conduct described above, directly or indirectly, in the offer or sale of securities by the use of means or instruments of transportation or communication in interstate commerce or by use of the mails:

a. with scienter, employed devices, schemes, or artifices to defraud;

b. obtained money or property by means of untrue statements of a material fact or by omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

c. engaged in transactions, practices or courses of business which operated or would operate as a fraud or deceit upon the purchaser.

84. By engaging in the conduct described above, defendants Wolff and Tafeen violated, and unless restrained and enjoined will continue to violate, Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a).

SECOND CLAIM FOR RELIEF

FRAUD IN CONNECTION WITH THE PURCHASE OR SALE OF SECURITIES

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

(Against Wolff and Tafeen)

85. The Commission realleges and incorporates by reference ¶¶ 1 through 81 above.

86. Defendants Wolff and Tafeen, by engaging in the conduct described above, directly or indirectly, in connection with the purchase or sale of a security, by the use of means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange, with scienter:

a. employed devices, schemes, or artifices to defraud;

b. made untrue statements of a material fact or omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

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c. engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon other persons.

87. By engaging in the conduct described above, defendants Wolff and Tafeen violated, and unless restrained and enjoined will continue to violate, Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

THIRD CLAIM FOR RELIEF

FRAUD IN CONNECTION WITH THE PURCHASE OR SALE OF SECURITIES

Aiding and Abetting Violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder

(Against Tafeen)

88. The Commission realleges and incorporates by reference ¶¶ 1 through 81 above.

89. Homestore violated Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5 by, directly or indirectly, in connection with the purchase or sale of a security, by the use of means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange, with scienter:

a. employing devices, schemes, or artifices to defraud;

b. making untrue statements of a material fact or omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

c. engaging in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon other persons.

90. Defendant Tafeen knowingly provided substantial assistance to Homestore's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

91. By engaging in the conduct described above and pursuant to Section 20(e) of the Exchange Act, 15 U.S.C. § 78t(e), defendant Tafeen aided and abetted Homestore's violations, and unless restrained and enjoined will continue to aid and abet, violations of Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

FOURTH CLAIM FOR RELIEF

VIOLATIONS OF COMMISSION PERIODIC REPORTING REQUIREMENTS

Aiding and Abetting Violations of Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder

(Against Wolff and Tafeen)

92. The Commission realleges and incorporates by reference ¶¶ 1 through 81 above.

93. Homestore violated Section 13(a) of the Exchange Act, 15 U.S.C. § 78m(a), and Rules 12b-20 and 13a-13, 17 C.F.R. §§ 240.12b-20 and 240.13a-13 thereunder, by filing with the Commission materially false and misleading quarterly reports on Forms 10-Q for the first three quarters of 2001.

94. Defendants Wolff and Tafeen, and each of them, knowingly provided substantial assistance to Homestore's violations of Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder.

95. By engaging in the conduct described above and pursuant to Section 20(e) of the Exchange Act, 15 U.S.C. § 78t(e), defendants Wolff and Tafeen aided and abetted Homestore's violations, and unless restrained and enjoined will continue to aid and abet violations, of Section 13(a) of the Exchange Act, 15 U.S.C. § 78m(a), and Rules 12b-20 and 13a-13 thereunder, 17 C.F.R.

§§ 240.12b-20 and 240.13a-13.

FIFTH CLAIM FOR RELIEF

RECORD-KEEPING VIOLATIONS

Aiding and Abetting Violations of Section 13(b)(2)(A) of the Exchange Act and Violations of Rule 13b2-1 thereunder

(Against Wolff and Tafeen)

96. The Commission realleges and incorporates by reference ¶¶ 1 through 81 above.

97. Homestore violated Section 13(b)(2)(A) of the Exchange Act by failing to make or keep books, records, and accounts that in reasonable detail accurately and fairly reflected its transactions and disposition of its assets.

98. Defendants Wolff and Tafeen knowingly provided substantial assistance to Homestore's violations of Section 13(b)(2)(A) of the Exchange Act.

99. By engaging in the conduct described above and pursuant to Section 20(e) of the Exchange Act, 15 U.S.C. § 78t(e), defendants Wolff and Tafeen aided and abetted Homestore's violations, and unless restrained and enjoined will continue to aid and abet violations, of Section 13(b)(2)(A) of the Exchange Act, 15 U.S.C. § 78m(b)(2)(A).

100. By engaging in the conduct described above, defendants Wolff and Tafeen violated Exchange Act Rule 13b2-1 by, directly or indirectly, falsifying or causing to be falsified Homestore's books, records, and accounts subject to Section 13(b)(2)(A) of the Exchange Act. Unless restrained and enjoined, defendants will continue to violate Rule 13b2-1, 17 C.F.R. § 240.13b2-1.

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<u>SIXTH CLAIM FOR RELIEF</u>

INTERNAL CONTROL VIOLATIONS

Violations of Section 13(b)(5) of the Exchange Act

(Against Wolff and Tafeen)

101. The Commission realleges and incorporates by reference ¶¶ 1 through 81 above.

102. By engaging in the conduct described above, defendants Wolff and Tafeen violated Section 13(b)(5) of the Exchange Act, which prohibits any person from circumventing or failing to implement a system of internal accounting controls, or from knowingly falsifying any book, record, or account described in Section 13(b)(2) of the Exchange Act. Unless restrained and enjoined, defendants Wolff and Tafeen will continue to violate Section 13(b)(5) of the Exchange Act, 15 U.S.C. § 78m(b)(5).

<u>SEVENTH CLAIM FOR RELIEF</u>

FALSE STATEMENTS TO AUDITORS

Violation of Exchange Act Rule 13b2-2

(Against Wolff)

103. The Commission realleges and incorporates by reference ¶¶ 1 through 81 above.

104. By engaging in the conduct described above, defendant Wolff violated Rule 13b2-2 of the Exchange Act by directly or indirectly making or causing to be made materially false or misleading statements to accountants and omitting to state, or causing another person to omit to state to accountants, material facts necessary in order to make statements made to the accountants, in light of the circumstances under which such statements were made, not misleading. Unless restrained and enjoined, defendant Wolff will continue to aid and abet violations of Exchange Act Rule 13b2-2, 17 C.F.R. § 240.13b2-2.

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PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that the Court:

I.

Issue findings of fact and conclusions of law that the defendants committed the alleged violations.

II.

Issue judgments, in a form consistent with Rule 65(d) of the Federal Rules of Civil Procedure, permanently enjoining defendants Wolff and Tafeen and their officers, agents, servants, employees, and attorneys, and those persons in active concert or participation with them, who receive actual notice of the order by personal service or otherwise, from violating or aiding and abetting violations of Section 17(a) of the Securities Act, Sections 10(b), 13(a), 13(b)(2)(A), and 13(b)(5) of the Exchange Act and Rules 10b-5, 12b-20, 13a-13, 13b2-1, and as to Wolff, Rule 13b2-2 of the Exchange Act.

III.

Order defendants Wolff and Tafeen to disgorge all ill-gotten gains from their illegal conduct, together with prejudgment interest thereon.

IV.

Order defendants Wolff and Tafeen to pay civil penalties under Section 20(d) of the Securities Act, 15 U.S.C. § 77t(d), and Section 21(d)(3) of the Exchange Act, 15 U.S.C. § 78u(d)(3).

V.

Enter an order, pursuant to Section 20(e) of the Securities Act, 15 U.S.C. § 77t(e), and Section 21(d)(2) of the Exchange Act, 15 U.S.C. § 78u(d)(2), prohibiting defendants Wolff and Tafeen from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act, 15 U.S.C. § 781, or that is required to file reports pursuant to Section 15(d) of the Exchange Act, 15 U.S.C. § 78o(d).

VI.

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered, or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

VII.

Grant such other and further relief as this Court may determine to be just and necessary.

DATED: April 27, 2005

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Jessica Rigley Marren
Attorney for Plaintiff
Securities and Exchange Commission