

1 BERNSTEIN LITOWITZ BERGER
& GROSSMANN LLP
2 ALAN SCHULMAN (Bar No. 128661)
ROBERT S. GANS (Pro Hac Vice)
3 BLAIR A. NICHOLAS (Bar No. 178428)
12730 High Bluff Drive, Suite 100
4 San Diego, CA 92130
Tel: (858) 793-0070
5 Fax: (858) 793-0323

-and-

6 DOUGLAS M. McKEIGE
1285 Avenue of the Americas
7 New York, New York 10019
Tel: (212) 554-1400
8 Fax: (212) 554-1444

9 Attorneys for Lead Plaintiff The
Policemen and Firemen Retirement
10 System of the City of Detroit
and Lead Counsel for the Class
11

12 **UNITED STATES DISTRICT COURT**
13 **NORTHERN DISTRICT OF CALIFORNIA**
14 **SAN JOSE DIVISION**

15
16 In re LEGATO SYSTEMS, INC.) Master File No. C-00-20111-JF
SECURITIES LITIGATION)
17) PSLRA CLASS ACTION
18 This Document Relates To:)
CONSOLIDATED AMENDED CLASS
19) ACTION COMPLAINT FOR
VIOLATION OF THE FEDERAL
20 ALL ACTIONS) SECURITIES LAWS
)
21) DEMAND FOR JURY TRIAL

1 Plaintiffs, on behalf of themselves and all others similarly
2 situated, allege as follows:

3 **NATURE OF THE ACTION**

4 1. This action is brought on behalf of plaintiffs and
5 other persons and entities who purchased the securities of Legato
6 Systems, Inc. ("Legato" or the "Company") from April 22, 1999
7 through May 17, 2000, inclusive (the "Class Period").

8 2. During the Class Period, Legato was locked in a highly-
9 competitive battle for customers and market share with two
10 principal competitors in the enterprise storage and recovery
11 software market. Throughout its fiscal year ended December 31,
12 1999 ("Fiscal 1999"), Legato represented that it was successfully
13 competing in its market, reporting sequential revenue growth in
14 each of the first three quarters of Fiscal 1999. As the Company
15 has now admitted, these financial results were materially false
16 and misleading.

17 3. During the Class Period, Legato's revenues were
18 generated primarily from two sources: (i) product licensing and
19 royalty revenues earned from product sales to resellers, end-
20 users and original equipment manufacturers ("OEMs"); and (ii)
21 service and support revenues generated from software updates,
22 support and education, and consulting services to end-users.
23 Under generally accepted accounting principles ("GAAP"), and as
24 represented in its own filings with the Securities and Exchange
25 Commission ("SEC"), Legato could not recognize revenue from the
26 sale of licenses to resellers unless an unconditional contract
27 existed and the fee was "fixed and determinable."
28

FOURTH QUARTER FISCAL 1999 REVISION

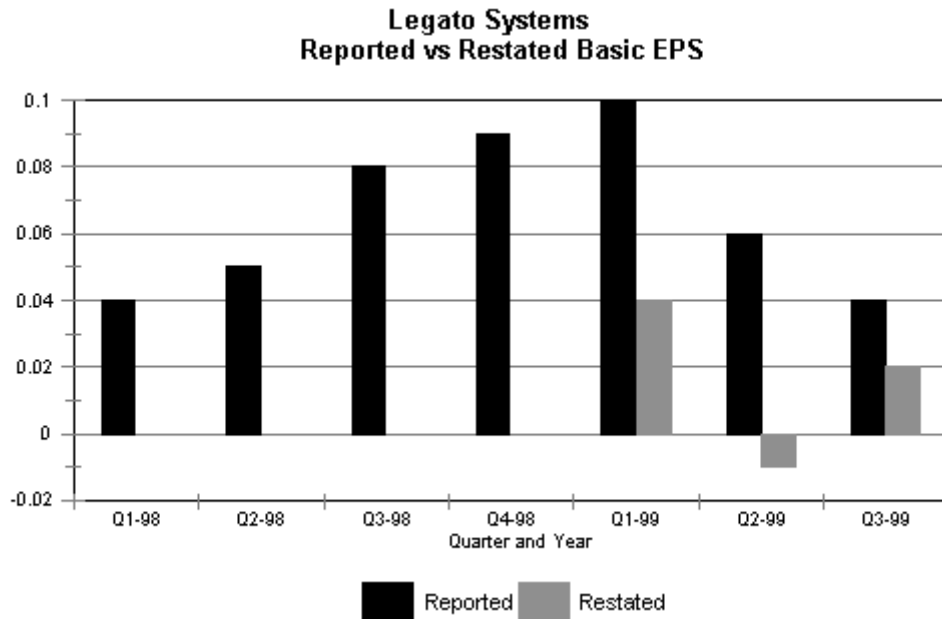
	<u>As Reported</u>	<u>As Revised</u>	<u>Amount Overstated</u>
Total Revenue	\$71,221,000	\$65,127,000	\$6,094,000
Gross Profit	\$61,787,000	\$55,693,00	\$6,094,000
Net Income (Loss)	\$3,052,000	(\$359,000)	\$3,411,000
Basic Earnings (Loss) Per Share	\$0.03	(\$0.00)	\$0.03

5. The business practices of Legato and its employees which gave rise to the financial misstatements now admitted by the Company were pervasive and occurred with the knowledge and, in some cases, the direct participation of senior management. As particularized below, the accounting irregularities admitted to by Legato were orchestrated and approved by defendants Cole and Wise, the Chief Executive Officer ("CEO"), and Chief Financial Officer ("CFO") of the Company, respectively. These two senior officers knowingly disseminated the materially false financial information to the market set forth herein, and sold significant amounts of Legato common stock at prices inflated by the fraudulent results.

6. The restatement of Legato's results for the first three quarters of Fiscal 1999, contained in three reports on Form 10Q/A filed with the SEC on June 8, 2000, show that Legato's actual growth in product license revenue during the first quarter of Fiscal 1999 was 12% -- not 38.5% as falsely reported by Legato during the Class Period. Growth product license revenue during the second quarter of Fiscal 1999 was 19% -- not 59% as falsely reported by Legato during the Class Period, while growth in product license revenue during the third quarter of Fiscal 1999

1 was 51%, not 63% as falsely reported. The impact of the
2 restatements on Legato's earnings growth trend is also very
3 dramatic and is demonstrated by the graph below:

4
5
6
7
8
9
10
11
12
13
14
15



16 7. By restating its financial results, Legato has admitted
17 that the publicly-issued financial statements for each of the
18 restated periods were not prepared in conformity with GAAP, and
19 that Legato materially misrepresented its financial condition and
20 results of operations. Under GAAP, the restatement of previously
21 issued financial statements is reserved for circumstances where
22 no lesser remedy is available. Under Accounting Principles Board
23 Opinion No. 20, *Accounting Changes*, restatements are only
24 permitted, and are required, to correct material accounting
25 errors or irregularities that existed at the time the financial
26 statements were prepared and issued.

27 8. By restating its financial statements, Legato has
28 admitted that each document publishing the original financial

1 results contained an untrue statement of material fact. Thus,
2 the restatement is an admission that each of the press releases
3 and the quarterly reports filed on Form 10-Q with the SEC for the
4 periods ended March 31, June 30 and September 30, 1999, contained
5 untrue statements of material fact.

6 9. The public dissemination of this materially false and
7 misleading financial information caused Legato's shares to trade
8 at artificially inflated prices throughout the Class Period. As
9 the false financial results were reported throughout Fiscal 1999,
10 Legato's stock price increased from \$42.125 per share at the
11 beginning of the Class Period to a Class Period high of \$82.50
12 per share on December 23, 1999. As the fraud was revealed and
13 assimilated by the marketplace, the price of Legato's stock
14 declined to a low of \$11.00 per share on May 19, 2000.

15 **JURISDICTION AND VENUE**

16 10. This Court has jurisdiction over the subject matter of
17 this action under Section 27 of the Securities Exchange Act of
18 1934 (the "Exchange Act"), 15 U.S.C. §78aa, and 28 U.S.C. §§
19 1331, 1337, and 1367. The claims alleged herein arise under
20 Sections 10(b) and 20(a) of the Exchange Act, 15 U.S.C. §§78j(b),
21 and Rule 10b-5 promulgated thereunder by the SEC.

22 11. Venue is proper in this District pursuant to Section 27
23 of the Exchange Act and 28 U.S.C. §1391(b). Many of the acts and
24 transactions giving rise to the violations of law complained of
25 herein, including the preparation and dissemination to the
26 investing public of materially false and misleading financial
27 statements, occurred in this District. Legato maintains its
28

1 principal executive offices in this District at 2350 West El
2 Camino Real, Mountain View, California 94040.

3 12. In connection with the acts, conduct and other wrongs
4 complained of herein, the defendants, directly or indirectly,
5 used the means and instrumentalities of interstate commerce, the
6 United States mails, and the facilities of a national securities
7 market.

8 **THE PARTIES**

9 13. (a) Lead Plaintiff, The Policeman and Fireman
10 Retirement System of the City of Detroit ("Detroit"), is a public
11 pension fund system located in Detroit, Michigan, which is
12 organized for the benefit of current and retired policemen and
13 firemen of the City of Detroit. During the Class Period, Detroit
14 purchased 32,800 shares of Legato common stock, and suffered
15 damages as a result of the violations of law alleged herein. On
16 May 10, 2000, the Court appointed Detroit as Lead Plaintiff for
17 the Class, as defined in ¶20, below, pursuant to Section 21D of
18 the Exchange Act, 15 U.S.C. §78u-4.

19 (b) Plaintiff Sovereign Bankcorp, Ltd. ("Sovereign")
20 is a California corporation with its headquarters in Newport
21 Beach, California. During the Class Period, Sovereign purchased
22 40,000 shares of Legato common stock, and suffered damages as a
23 result of the violations of law alleged herein.

24 (c) Plaintiff Robert B. Rutherford ("Rutherford") is
25 an individual who resides in the State of Ohio. During the Class
26 Period, Rutherford purchased 10,000 shares of Legato common stock
27 and suffered damages as a result of the violations of law alleged
28 herein.

1 (d) Plaintiff Edward Berger ("Berger") is an
2 individual who resides in the State of New Jersey. During the
3 Class Period, Berger purchased 14,000 shares of Legato common
4 stock and suffered damages as a result of the violations of law
5 alleged herein.

6 14. Defendant Legato is in the business of manufacturing
7 and marketing network storage management software products. The
8 Company licenses its products through distributors, systems
9 integrators and value-added resellers (collectively,
10 "resellers"), and directly to end-users located in North America,
11 Europe and Asia Pacific. The Company also licenses its source
12 code to OEMs in exchange for licensing fees and royalties from
13 the OEMs' product sales.

14 15. (a) Defendant Louis C. Cole ("Cole") has served as
15 President, CEO and a director of Legato since 1989. In April
16 1995, he was named Chairman of the Board and continued to hold
17 that position throughout the Class Period. Cole is also one of
18 the largest shareholders of the Company.

19 (b) By virtue of his positions with Legato as CEO and
20 Chairman, and the size of his holdings of Legato common stock,
21 Cole was a controlling person of the Company and exercised his
22 power and influence to cause Legato to engage in the wrongful
23 conduct complained of herein.

24 (c) Cole, along with CFO Wise, was responsible for
25 Legato's communications to securities analysts and investors
26 during the Class Period. Cole also reviewed and authorized the
27 release of Legato's publicly reported quarterly financial
28 statements for Fiscal 1999, the Company's reports on Form 10-Q

1 filed with the SEC for each of these periods, and its financial
2 press releases and other group-published corporate reports.

3 (d) Cole knew or was deliberately reckless in
4 disregarding the fact that the Company's internal controls,
5 designed to ensure accurate financial reporting by Legato, were
6 weak or non-existent. For example, Cole knew that the Company
7 did not have a functioning Audit Committee of its Board. In
8 fact, Cole was responsible for appointing Philip White to the
9 Legato Board and installing him as a member of Legato's two-
10 person Audit Committee. Cole knew that White had been fired in
11 July 1997 as CEO and Chairman of Informix Corporation for his
12 role in a massive accounting fraud scandal in which Informix
13 admitted that it had improperly recognized hundreds of millions
14 of dollars of revenue on phony sales to resellers, and restated
15 its financial results for 1994, 1995, and 1996 based upon these
16 "pervasive" "errors and irregularities." Cole also knew that
17 Legato's Audit Committee, which had responsibility for overseeing
18 the Company's accounting practices, failed to hold any meetings
19 during the fiscal year ended December 31, 1998 ("Fiscal 1998"),
20 and held only one meeting during Fiscal 1999 -- a period during
21 which Legato's reported quarterly revenues increased more than
22 100%, from \$34 million to over \$70 million.

23 (e) Further, Cole knew that Legato set aggressive
24 growth targets and pressured its sales personnel each quarter to
25 "make the numbers." Cole presided over weekly "executive
26 management" meetings held in a conference room next to his office
27 in Legato's headquarters, which were attended by CFO Wise and top
28 sales personnel. The primary purpose of these weekly meetings

1 was to update and discuss the financial outlook for the current
2 quarter and to review larger enterprise license agreements
3 anticipated to close during the quarter. Through these meetings,
4 Cole closely monitored the progress of these "big deals," as they
5 were commonly referred to in the Company, as well as Legato's
6 progress toward meeting revenue and earnings targets in each
7 quarter.

8 (f) From these weekly executive management meetings and
9 his own direct involvement in the Company's sales activities,
10 Cole knew that resellers were unwilling to commit to large
11 enterprise license agreements unless an end-user committed to
12 purchase the product from the reseller. Cole also knew that, to
13 induce resellers to issue purportedly non-reversible purchase
14 orders for these products, Legato typically entered into "side
15 agreements" which often made payment contingent upon sale of the
16 product to the intended end-user. In fact, during the third
17 quarter of Fiscal 1999, Cole became so concerned that Legato's
18 outside auditors would discover these hidden side agreements, and
19 force the Company to reverse the revenue booked on these
20 contingent sales, that he directed CFO Wise to prepare a form
21 letter, to be signed by the CFO or CEO of every Legato reseller,
22 "acknowledging" that the products purchased by the reseller could
23 not be returned. Cole knew that every reseller who received a
24 copy declined to sign and return the letter to Legato.
25 Nevertheless, as detailed below, Cole continued to permit Legato
26 to recognize revenue derived from contingent sales to these
27 resellers in violation of GAAP, thereby artificially inflating
28 the Company's revenues and earnings.

1 (g) Cole also directly participated in the negotiation
2 of the bogus transactions that succeeded in artificially
3 inflating the Company's revenues and earnings during the Class
4 Period. For example, as detailed in ¶¶50-51, below, Cole was
5 directly involved in the negotiation of a transaction with end-
6 user Storage Networks, Inc. ("SNI"), pursuant to which Legato
7 attempted to book millions of dollars in revenue despite the fact
8 that SNI's payment obligation was contingent upon Legato's
9 purchase of an equal amount of product from SNI. Indeed, Cole
10 was instrumental in negotiating the terms of this agreement,
11 which provided for the simultaneous execution of two separate
12 contracts, neither of which referred to the other, in an effort
13 to hide the contingent nature of the transaction from Legato's
14 outside auditors.

15 (h) Cole also had direct knowledge of other
16 transactions that artificially inflated Legato's revenue and
17 earnings results. For example, as detailed in ¶¶45-47, below,
18 Cole participated in an emergency meeting with Legato's outside
19 auditors prior to the filing of the Company's Form 10-Q for the
20 third quarter of Fiscal 1999, during which the auditors warned
21 Cole and Wise that the Company could not record millions of
22 dollars in revenue derived from a product license agreement
23 entered into with reseller Logicon, purportedly on behalf of the
24 United States Air Force. Cole ignored the auditors' warning, and
25 instead authorized the Company to include the revenue in its
26 quarterly report on Form 10-Q.

27 (i) During the Class Period, Cole sold 246,000 shares
28 of Legato stock on the open market at prices ranging from \$64.50

1 to \$77.88 per share, realizing gross proceeds of more than \$15.9
2 million. Cole sold 75,000 of these shares, for proceeds of \$4.8
3 million, in late November 1999, shortly after the "emergency
4 meeting" in which Legato's auditors advised the Company not to
5 record revenues derived from the Air Force transaction described
6 above. When selling his stock, Cole either knew or, but for his
7 deliberate recklessness, should have known that Legato's
8 quarterly results were overstated by millions of dollars, and
9 that the Company's outside auditors would force Legato to restate
10 these results to reverse the Air Force transaction at year-end.

11 (j) On July 26, 2000, Legato announced that Cole would
12 step-down as President of the Company, and that a search was
13 underway to find a replacement.

14 16. (a) Defendant Stephen C. Wise ("Wise") served as Senior
15 Vice President and CFO of Legato since 1996. Wise participated
16 in the day-to-day control of the Company and orchestrated the
17 preparation of Legato's false financial statements. By reason of
18 his positions as Senior Vice President and CFO, Wise was a
19 controlling person of Legato, and used his power and influence to
20 cause Legato to engage in the unlawful conduct alleged herein.

21 (b) As particularized below, Wise orchestrated the
22 scheme alleged herein to inflate Legato's reported revenues and
23 earnings throughout Fiscal 1999. During the Class Period, Wise
24 approved the booking of revenue on contingent transactions with
25 resellers even though he knew that revenue recognition was
26 improper under GAAP and violated the Company's stated revenue
27 recognition policies.

28

1 (c) Wise actively participated in weekly "executive
2 management" meetings with defendant Cole and top sales personnel
3 throughout the Class Period. During Fiscal 1999, Wise monitored
4 Legato's total dollar exposure on reseller transactions with side
5 agreements and kept Cole informed of the total exposure from such
6 improper transactions.

7 (d) Wise also was responsible for reviewing and
8 approving terms of all product licensing agreements whose terms
9 varied from the standard terms provided to customers, along with
10 all "big deals." For example, Wise knew that Legato maintained a
11 policy of only selling products to resellers who had already
12 designated an end-user to purchase the product. Further,
13 consistent with this policy, Legato embedded its software with an
14 encryption code "keyed" to the particular end-user designated for
15 the transaction. Despite this policy, Wise knew that sales
16 personnel were assuring resellers throughout the Class Period
17 that they could return product not ultimately purchased by end-
18 users. Among other things, Wise authorized the use of side
19 agreements which allowed resellers to "return and rotate" product
20 if the deal with the end-user fell through, as detailed in ¶¶42-
21 44, below, pursuant to which Legato agreed to "re-key" the
22 product to a new end-user when and if it materialized. For the
23 reasons set forth in ¶¶55-60, below, Wise also knew that the
24 "return and rotate" side agreements were a subterfuge to disguise
25 the contingent nature of the contracts, and that revenue
26 recognition on such transactions violated GAAP. Nevertheless,
27 Wise knowingly allowed material amounts of reseller deals to be
28

1 booked in each quarter of Fiscal 1999 pursuant to these improper
2 agreements.

3 (e) Wise also knew that, by the third quarter of Fiscal
4 1999, Cole was concerned about the growing number of contingent
5 reseller deals booked earlier in the Class Period that had not
6 sold through to end-users, which triggered the resellers' rights
7 of return. Thus, pursuant to Cole's instructions, and in an
8 effort to hide these contingent sales from Legato's outside
9 auditors, Cole prepared the form letter described in 15(f),
10 above, directing each reseller to "acknowledge" that no right of
11 return existed. Wise knew that none of the resellers signed the
12 acknowledgment, yet he continued to allow Legato to book revenue
13 from these contingent sales and to artificially inflate its
14 reported quarterly financial results based on these transactions.

15 (f) Wise also actively participated in negotiating the
16 terms of the bogus "reciprocal" transaction with SNI described in
17 ¶¶50-51, below, and also participated in the "emergency meeting"
18 in November 1999 in which Legato's auditors advised against
19 booking revenues from the Air Force transaction during the third
20 quarter. Wise not only authorized the recognition of revenue
21 despite this advice, but also signed and authorized the filing of
22 the false Form 10-Q which included revenues from the Air Force
23 transaction, as set forth in ¶¶86-88, below.

24 (g) Wise also caused the Company to improperly
25 recognize revenue on other contingent transactions or product
26 license agreements in which the reseller retained the right to
27 return the product. During the Class Period, as detailed in
28 ¶¶45-47, 50-51, below, Wise directly participated in the

1 negotiation of such transactions with reseller Logicon, as well
2 as end-user SNI. Wise also participated in the dissemination of
3 Legato's financial results for the first three quarters of Fiscal
4 1999 and signed Legato's reports on Form 10-Q filed for the
5 quarters ended March 31, June 30, and September 30, 1999,
6 although he knew that the financial statements contained therein
7 were false.

8 (h) During the Class Period, Wise sold 111,968 shares
9 of Legato stock in the open market, at prices ranging from \$37.25
10 to \$72.82 per share, realizing proceeds of over \$6.5 million.
11 Wise sold 40,422 of these shares for proceeds of over \$2.6
12 million in late November 1999, shortly after the "emergency
13 meeting" at which Legato's outside auditors advised against
14 booking revenues from the Air Force transaction described above.
15 At the time he sold this stock, Wise either knew or, but for his
16 deliberate recklessness, should have known that Legato would be
17 forced to restate its financial results at year-end to eliminate
18 revenues derived from the Air Force transaction.

19 (i) On July 26, 2000, Legato announced that Wise would
20 resign from the Company.

21 17. Defendants Cole and Wise (collectively, the "Individual
22 Defendants") possessed the power and authority to control the
23 contents of Legato's SEC reports and filings, press releases and
24 presentations to securities analysts and knew that such
25 information was conveyed through the analysts to the investing
26 public. Because of their positions they were able to and did
27 control the contents of the various quarterly and annual
28 financial reports, SEC filings, press releases, and presentations

1 to securities analysts pertaining to Legato, which the Company
2 has now admitted were materially false and misleading when
3 issued.

4 18. Cole and Wise reviewed each of Legato's press releases
5 and SEC filings, alleged herein to be false prior to their
6 issuance, and had the ability to prevent their issuance and the
7 authority to cause them to be corrected. They had a duty to
8 promptly disseminate accurate and truthful information with
9 respect to Legato's products, operations, financial condition and
10 future business prospects or to cause and direct that such
11 information be disseminated so that the market price of Legato's
12 shares would be based on truthful and accurate information.

13 19. Cole and Wise knew, or were deliberately reckless in
14 disregarding, that the illegal acts and practices and misleading
15 statements described herein would adversely affect the integrity
16 of the market for Legato stock and would artificially inflate or
17 maintain the price of Legato stock during the Class Period.

18 **CLASS ALLEGATIONS**

19 20. Plaintiffs bring this action as a class action pursuant
20 to Federal Rules of Civil Procedure 23(a) and 23(b) (3) on behalf
21 of a class (the "Class") of all persons who purchased Legato
22 securities on the open market between April 22, 1999 -- the first
23 day of trading after Legato announced its financial results for
24 the first quarter of Fiscal 1999 -- through May 17, 2000,
25 inclusive (the "Class Period"), and who were damaged thereby.
26 Excluded from the Class are: the defendants herein; members of
27 the families of each of the Individual Defendants; any parent,
28 subsidiary, affiliate, partner, officer, executive or director of

1 any defendant; any entity in which any such excluded person has a
2 controlling interest; and the legal representatives, heirs,
3 successors and assigns of any such excluded person or entity.

4 21. The members of the Class are so numerous that joinder
5 of all members is impracticable. While the exact number of Class
6 members is unknown to plaintiff at the present time and can only
7 be ascertained from books and records maintained by Legato and/or
8 its agent(s), plaintiffs believe that Class members number in the
9 thousands. As of April 30, 2000, the Company had 86,828,506
10 shares of common stock issued and outstanding which, at all
11 relevant times, traded on the NASDAQ National Market System, an
12 efficient market. During the Class Period, Legato was followed
13 and reported on by analysts at numerous securities firms,
14 including SG Cowen, Hoak Breedlove, CIBC Oppenheimer, Hambrecht &
15 Quist and BancBoston Robertson Stephens.

16 22. Common questions of law and fact exist as to all
17 members of the Class and predominate over any questions solely
18 affecting individual members of the Class. Among the questions
19 of law and fact common to the Class are:

20 (a) Whether the federal securities laws were violated
21 by defendants' acts and omissions as alleged herein;

22 (b) Whether defendants participated in and pursued the
23 common course of conduct and fraudulent scheme complained of
24 herein;

25 (c) Whether the documents, reports, filings, releases,
26 and statements disseminated to the Class by defendants during the
27 Class Period misrepresented material facts about the business,
28 performance, and financial condition of Legato;

1 (d) Whether defendants acted knowingly or with
2 deliberate recklessness in misrepresenting material facts;

3 (e) Whether the market price of Legato common stock
4 during the Class Period was artificially inflated due to the
5 misrepresentations complained of herein; and

6 (f) Whether plaintiffs and the other members of the
7 Class have sustained damages and, if so, the appropriate measure
8 thereof.

9 23. Lead Plaintiff and the other named plaintiffs will
10 fairly and adequately represent and protect the interests of the
11 members of the Class. Lead Plaintiff has retained competent
12 counsel experienced in class and securities litigation and
13 intends to prosecute this action vigorously. Plaintiffs are
14 members of the Class and do not have interests antagonistic to,
15 or in conflict with, the other members of the Class.

16 24. Plaintiffs' claims are typical of the claims of the
17 members of the Class. Plaintiffs and all members of the Class
18 purchased Legato securities during the Class Period at
19 artificially inflated prices and have sustained damages arising
20 out of the wrongful course of conduct alleged herein.

21 25. A class action is superior to other available methods
22 for the fair and efficient adjudication of this controversy.
23 Since the damages suffered by individual class members may be
24 relatively small, the expense and burden of individual litigation
25 make it virtually impossible for the Class members individually
26 to seek redress for the wrongful conduct alleged. Plaintiffs
27 know of no difficulty that will be encountered in the management
28

1 of this litigation that would preclude its maintenance as a class
2 action.

3 **THE FRAUDULENT ACCOUNTING SCHEME**

4 26. Legato develops, markets, and provides technical
5 support for a wide range of data storage management products
6 designed to support diverse computer networks. The Company's
7 products are designed to work on a variety of operating systems,
8 including NetWare, Windows NT, and UNIX, and provide the means
9 for customers to back-up and archive computer data efficiently,
10 without placing excessive strain on the network.

11 27. Beginning in 1998, Legato began to focus its sales
12 efforts on large, "enterprise-level" license transactions, in
13 which the Company provides an enterprise-wide suite of data
14 storage and disaster recovery products designed to fulfill the
15 end-users' total data management needs. These transactions are
16 often very large, ranging from hundreds of thousands to millions
17 of dollars in value per transaction.

18 28. Legato's focus on obtaining enterprise-level license
19 contracts has fueled substantial growth in the Company's business
20 in recent years. Product license sales were not only the most
21 significant contributor to the Company's operating performance in
22 Fiscal 1998, accounting for 63.8% of revenues, but also were
23 Legato's most profitable business area during this time frame.
24 By focusing on high margin product license sales, Legato was able
25 to grow profits at a faster rate than revenues. This, in turn,
26 fueled a substantial increase in the price of Legato common
27 stock, which rose to a high of \$65.94 per share during the final
28 quarter of Fiscal 1998.

1 29. The dramatic rise in the price of Legato common stock
2 provided the means for the company to pursue strategic
3 acquisitions of complementary businesses, while using its stock
4 as currency for these purchases. For example:

5 (a) On August 6, 1998, Legato entered into a
6 definitive agreement for the acquisition of Software Moguls,
7 Inc., a developer of advanced backup-retrieval products for the
8 Windows NT and UNIX environments, in exchange for 250,000 shares
9 of Legato common stock;

10 (b) On October 25, 1998, the Company entered into a
11 definitive agreement to acquire Qualix Group, Inc. (dba FullTime
12 Software, Inc.) ("FullTime"), a developer of distributed,
13 enterprise-wide, cross-platform, adaptive computing solutions, in
14 exchange for 1,721,000 shares of Legato common stock; and

15 (c) On January 28, 1999, Legato entered into a
16 definitive agreement to acquire Intelliguard Software, Inc.
17 ("Intelliguard"), a developer of standards-based storage
18 management solutions for Storage Area Networks ("SAN"), in
19 exchange for \$9,112,500 in cash and 720,000 shares of Legato
20 common stock.

21 30. Although Legato maintains a direct sales force for the
22 purpose of marketing its large, highly profitable enterprise
23 license agreements, the customized nature of the software
24 packages subject to these agreements often requires on-site
25 customization and integration that the Company is not equipped to
26 provide. Further, the relatively small size of Legato's direct
27 sales force limits its ability to penetrate the enterprise
28 license market and secure large product license sales.

1 31. To broaden the reach of its marketing efforts while
2 also providing "one-stop" sales and support shopping for its end-
3 user customers, Legato relies heavily upon value-added resellers,
4 such as third party integrators, for the majority of its
5 revenues. As detailed in the Company's annual report on Form 10-
6 K for Fiscal 1998 (the "1998 Form 10-K"), these resellers
7 purchase the product licenses from Legato, and then resell the
8 license to a specified end-user through Legato's Enterprise
9 Solution Partners program:

10 The Enterprise Solution Partners program enables
11 third-party integrators specializing in storage
12 management and client/server network solutions to
13 provide end user customers with complete
14 solutions, including systems and storage hardware,
15 complementary software and our software. The
16 reseller is responsible for managing the sales and
17 installation process in each customer situation.
18 In large, complex opportunities, our support
19 personnel work with the reseller to provide
20 technical support. This approach enables us to
21 cost effectively achieve broader market coverage,
22 while maintaining close contact with end user
23 customers in order to obtain input on product
24 direction and to monitor customer satisfaction.

25 32. Despite the expectation that resellers would sell
26 Legato's products to end-users, GAAP prohibits recognition of any
27 revenue from a sale to a reseller that is contingent for payment
28 upon the reseller's subsequent sale of the product to the end-
user. Therefore, Legato represented in its filings with the SEC
both before and during the Class Period that the Company
recognizes revenue from product license sales to resellers only
if the transaction is not contingent upon resale to the end-user.
Indeed, in its 1998 Form 10-K, Legato contrasted these reseller
transactions with contingent sales to distributors, where the

1 Company purported not to recognize revenue until the distributor
2 sold the product to the end-user:

3 [T]he Company recognizes product revenue upon
4 shipment if a signed contract exists, the fee is
5 fixed and determinable, collection of resulting
6 receivables is probable and product returns are
7 reasonably estimable, except for sales to domestic
8 distributors which are recognized upon sale by the
9 distributor to end-users. The Company has
10 recognized revenue from domestic distributors upon
11 sale by the distributor to end users since these
12 distributors have unlimited rights of return and
13 the Company historically has not been able to make
14 reasonable estimates of product returns from these
15 distributors.

16 33. Legato reiterated these representations concerning its
17 revenue recognition policies in each of its quarterly reports
18 filed with the SEC during the Class Period for the quarters ended
19 March 31, June 30, and September 30, 1999, as set forth below:

20 We recognize product license revenue upon
21 shipment if a signed contract exists, the fee is
22 fixed and determinable, collection of resulting
23 receivables is probable and product returns are
24 reasonably estimable, except for sales to domestic
25 distributors, which are recognized upon sale by
26 the distributors to end-users. We recognize
27 revenue from domestic distributors upon sale by
28 the distributor to end-users since these
29 distributors have unlimited rights of return and
30 we historically have not been able to make
31 reasonable estimates of product returns from these
32 distributors.

33 Thus, Legato assured the readers of its SEC filings during the
34 Class Period that its revenues and earnings were not improperly
35 inflated through the improper recognition of revenue from
36 contingent sales from which Legato might never receive payment.

37 34. Nevertheless, as the size of the enterprise license
38 agreements pursued by Legato grew, the Company's difficulty in
39 closing these transactions also increased, as purchase
40 commitments from end-users required approval at the top echelons

1 of management. Further, without a purchase commitment from an
2 end-user, Legato's resellers were unwilling to enter into
3 irrevocable, non-contingent "big deal" software licensing
4 agreements and unconditionally obligate themselves to purchase
5 the product with uncertain sell-through prospects. Instead, the
6 resellers required significant inducements to accommodate
7 Legato's pressure to enter into such transactions as the Company
8 neared the end of each reporting period.

9 35. Faced with these obstacles to revenue and earnings
10 growth, defendants embarked upon a scheme in which they knowingly
11 violated their own revenue and recognition policies, as set forth
12 in ¶¶15-16, above, and instead caused Legato to inflate its
13 reported revenue and earnings through the use of side agreements
14 with resellers to induce them to enter into "big deals," the term
15 used within the Company to describe enterprise software license
16 agreements.

17 36. In these transactions, Legato knowingly recognized
18 revenue from software licensing deals with resellers despite the
19 fact that one or more conditions for proper recognition of
20 revenue under GAAP were never met, including the following: (i)
21 the product was never delivered to the reseller; (ii) the fees
22 owed to Legato on the sale were not fixed and determinable; (iii)
23 collectability of the fee was not probable; or (iv) the
24 reseller's obligation to pay for the product was contingent upon
25 subsequent sale of the product to the end-user. In addition,
26 Legato provided certain resellers with side payments, deep
27 discounts on future product offerings, and rebate arrangements to
28 induce them to enter into enterprise license agreements where no

1 end-user had committed to purchase the product. Indeed, as
2 detailed below, defendants caused Legato to recognize revenue
3 based upon these transactions even after being informed by the
4 Company's outside auditors, the international accounting firm of
5 PricewaterhouseCoopers LLP ("PWC"), that recognition of revenue
6 from certain of these transactions was prohibited under GAAP.
7 Examples of such transactions during the Class Period include the
8 following:

9 Q1 1999 Transactions

10 37. In March 1999, Legato improperly recognized \$1.4
11 million in product license revenue based upon a purported sale of
12 its Networker and Smart Media products to the Internal Revenue
13 Service ("IRS"), despite the fact that the IRS did not agree to
14 purchase the products until June 1999 - three months later.
15 Indeed, Legato never shipped any products "keyed" for the IRS,
16 during the first quarter. Instead, in March 1999, Legato entered
17 into a side agreement with one of its resellers, DLT, pursuant to
18 which DLT agreed to "hold" the products targeted for the IRS in
19 return for a \$150,000 payment from Legato once a purchase
20 commitment had been secured from the IRS. It was explicitly
21 agreed that DLT had no obligation to purchase the product if a
22 purchase commitment from the IRS never materialized. In return
23 for this assurance, DLT issued a non-cancellable purchase order
24 and Legato recognized revenue on the contract. DLT, however,
25 never took delivery of the products keyed for the IRS. Instead,
26 when the IRS finally committed to the purchase in June 1999,
27 Legato altered its internal accounting records to show that the
28 product had been transferred from DLT to Storage Tech, another

1 Legato reseller, even though the product had never been delivered
2 to DLT. Legato then shipped the products directly to Storage
3 Tech, who completed the transaction with the IRS. In return for
4 its participation in this sham transaction, Legato paid DLT
5 \$150,000.

6 38. Another bogus transaction booked during the first
7 quarter was a \$500,000 reseller deal for products keyed for end-
8 user Dow Industrial. Dow Industrial never agreed to purchase any
9 products from Legato during the first quarter. Instead, in late
10 March 1999, Legato induced reseller Vanguard to issue a purchase
11 order for the products keyed for Dow Industrial in return for,
12 among other things, extended payment terms of 90-days, well
13 beyond the customary 30-day payment terms provided to resellers
14 in their contracts with Legato, and assurances that Vanguard
15 would not be required to pay for the products if Dow Industrial's
16 purchase commitment failed to materialize. Legato never
17 delivered the Dow Industrial products to Vanguard as required to
18 recognize revenue, even though it booked \$500,000 in revenue from
19 the transaction during the quarter.

20 39. By the end of June 1999, Dow Industrial still had not
21 committed to purchase the products held by Vanguard. Legato did
22 not require Vanguard to pay \$500,000 for the goods. Instead, it
23 arranged to substitute MTI for Vanguard, as the ostensible
24 reseller of the goods. Like Vanguard, MTI never accepted
25 delivery of the underlying products, nor did it assume any
26 obligation to pay for the goods until they were resold to end-
27 user Dow Industrial.

28

1 40. By September 1999, Dow Industrial still had not
2 committed to purchase the goods now held by MTI. Again, Legato
3 did not require MTI to pay for the goods. Instead, Legato
4 arranged to substitute Storage Tech for MTI as the ostensible
5 reseller of the goods keyed to Dow Industrial, again with a side
6 agreement that made Storage Tech's obligation to pay contingent
7 upon sell-through to the end-user. Finally, in October 1999 -
8 seven months after Legato recognized \$500,000 in revenue on this
9 transaction through its original agreement with Vanguard - Dow
10 Industrial committed to purchase the goods and Legato finally
11 received payment.

12 Q2 1999 Transactions

13 41. During the second quarter of Fiscal 1999, Legato
14 inflated its reported revenues by over \$10 million by engaging in
15 more improper transactions in contravention of the assurances
16 provided by the Company set forth in ¶¶31-33, above, and in
17 violation of GAAP. For example, Legato booked revenues from at
18 least five product license agreements with reseller Vanguard
19 during the quarter, despite the fact that Vanguard could return
20 the product to Legato if a subsequent transaction with the end-
21 user did not materialize. With respect to four of these
22 transactions intended for end-users Richardson School District,
23 CLR, IXC and Blockbuster, Legato entered into side agreements
24 with Vanguard providing that the reseller could return the
25 product for full refund if the end-user did not agree to purchase
26 the goods. In return for these side agreements, Vanguard issued
27 purportedly "non-cancellable" purchase orders for each product
28

1 license agreement, and Legato improperly recognized revenue for
2 the full amount of each purchase order.

3 42. Legato also improperly booked revenue during the second
4 quarter on another license agreement with Vanguard keyed for end-
5 user MCI/UUNET, despite the fact that Legato provided Vanguard
6 with "return and rotate" rights if the end-user failed to
7 consummate the transaction. Specifically, as discussed in ¶32-
8 33, above, Legato's internal policies contemplate sales of
9 products to resellers only when an end-user has committed to
10 purchasing the product. Accordingly, Legato encrypts software
11 provided to its resellers, and also supplies the reseller with
12 the "key" that permits the designated end-user to install and use
13 the software. Once the software is encrypted, only the specified
14 end-user may use the software that is the subject of the
15 transaction.

16 43. "Return and rotate" terms were devised to avoid this
17 control on transactions with resellers where no end-user had
18 committed to purchase the product. Thus, in the MCI/UUNET
19 transaction, Legato assured Vanguard in a side agreement that, if
20 the end-user did not commit to purchase the product, Vanguard
21 could return it, and Legato would change the key so that Vanguard
22 could "rotate" the product to a new end-user if one materialized.

23 44. Legato also booked revenues in the second quarter from
24 transactions with reseller Applied Digital Systems ("ADS"),
25 despite the fact that ADS had a right of return if the end-user
26 did not commit to purchase the product. For example, in late
27 June 1999, ADS issued a purchase order for a \$250,000 licensing
28 agreement although no end-user had committed to purchase the

1 product. To induce ADS to sign the standard purchase agreement,
2 which purported to unconditionally obligate the reseller to pay
3 within 30 days, Legato entered into a side agreement that allowed
4 ADS, among other things, 90-day extended payment terms and
5 assurances that if it could not close the deal with the keyed
6 end-user, ADS had no obligation to pay for the product, or could
7 exercise "return and rotate rights." As an additional incentive,
8 Legato also agreed to increase the credit limits offered to ADS
9 to purchase Legato products, despite the fact that an increase
10 was not permitted under Legato's internal credit criteria, and
11 collectability of the license fee was therefore not probable.

12 Q3 1999 Transactions

13 45. Legato improperly recognized millions of dollars in
14 revenues from contingent sales to resellers during the third
15 quarter despite having been warned by its auditors, PWC, against
16 recognizing revenues on one such transaction that PWC discovered
17 in early November 1999. Specifically, PWC learned that Legato
18 had booked \$5.8 million in revenues during the third quarter of
19 Fiscal 1999 on the sale of Networker and Smart Media products to
20 the United States Air Force through government contract reseller
21 Logicon. Pursuant to the terms of this transaction, Logicon
22 agreed to issue a purchase order for the products keyed to the
23 Air Force, in return for Legato's agreement to substitute another
24 end-user if the Air Force failed to commit to the purchase.

25 46. On or about November 8, 1999, prior to the filing of
26 the Company's third quarter Form 10-Q with the SEC, Larry De
27 Bower, a PWC partner, convened an "emergency meeting" with Cole
28 and Wise at Legato's executive offices, at which he stated that

1 PWC believed revenue should not be recognized on the Air Force
2 contract in the third quarter. De Bower further informed them
3 that PWC's conclusion was based primarily upon Legato's agreement
4 to find a substitute end-user for the products if the Air Force
5 did not commit, rendering Logicon's obligation to pay contingent
6 and precluding revenue recognition.

7 47. Legato booked \$5.8 million in revenue from this
8 transaction, despite the fact that PWC warned defendants Cole and
9 Wise that recognition of revenue under these circumstances was
10 improper under GAAP, and would require restatement at year-end if
11 recorded.

12 48. As detailed in ¶110, below, defendants Cole and Wise
13 sold millions of dollars in Legato stock shortly after this
14 meeting, knowing or deliberately disregarding the fact that PWC
15 would require Legato to reverse this transaction and restate its
16 third quarter results at year-end.

17 Q4 1999 Transactions

18 49. As the year-end approached, Cole and Wise became
19 concerned that the Company's average days sales outstanding
20 ("DSOs"), (i.e., the average amount of time it takes for the
21 Company to receive payment on its receivables), had materially
22 increased due to the amount of undisclosed, contingent sales to
23 resellers, and the lack of payment from these sales. They
24 worried not only about the market reaction to a sharp increase in
25 DSOs, but also that PWC would discover that the increase was
26 attributable to revenues booked on contingent reseller deals.
27 Cole and Wise also were concerned about an expected shortfall in
28 fourth quarter results, the effects of which would be exacerbated

1 if PWC required Legato to restate the Air Force transaction at
2 year-end.

3 50. In late December 1999, to cover the quarterly revenue
4 shortfall, Cole and Wise directly participated in negotiating a
5 \$10 million bogus transaction with end-user SNI, a data storage
6 provider. The SNI deal ostensibly required SNI to purchase \$10
7 million in software from Legato that SNI would then package with
8 its own software and sell to SNI's customers. Under the
9 contract, Legato would receive \$30,000 for each package SNI sold
10 to its customers, and SNI was given three years to pay the \$10
11 million. In addition, Legato agreed to provide SNI with
12 personnel to assist SNI with sell-through and service to SNI
13 customers. The quid pro quo for this transaction, which Cole and
14 Wise directly participated in negotiating with SNI, was that
15 Legato would simultaneously enter into a reciprocal agreement
16 with SNI to purchase \$10 million of SNI data storage over a four
17 year period.

18 51. Cole and Wise knew that GAAP prohibited upfront revenue
19 recognition on this transaction since the reciprocal nature of
20 the agreement, along with Legato's continuing obligation to
21 provide personnel to SNI, rendered the agreement a contingent
22 sale. Initially, SNI's CEO, Peter Bell, refused to memorialize
23 the understanding in a side letter and insisted that the
24 reciprocal obligation be reflected in the primary contract. Wise
25 and Cole knew that the improper revenue recognition would be
26 easily discovered if this were done, so they suggested a
27 compromise whereby Legato and SNI would execute two separate
28 stand alone agreements, neither of which would reference the

1 reciprocal nature of the "true" agreement. The purpose of this
2 subterfuge was to hide the true substance of the transaction from
3 PWC. With this subterfuge in place, Wise and Cole caused \$10
4 million in revenue for this transaction to be improperly booked
5 as revenue in the fourth quarter.

6 52. In addition to the SNI transaction, Legato booked
7 material amounts of contingent license sales agreements with
8 resellers during the fourth quarter, despite the fact that the
9 resellers' payment obligations were fully contingent upon resale
10 to the end-user. For example, in December 1999, Legato booked
11 revenues from product license sales to reseller CMC for goods
12 keyed to the University of Pennsylvania Medical Center, despite
13 the fact that CMC's payment obligation was contingent upon sell-
14 through to the end-user. Indeed, the side agreement entered into
15 between Legato and CMC further provided that the reseller could
16 return the products to Legato for a full refund if no end-user
17 purchased the license. Legato's improper booking of revenue
18 based upon this transaction contributed to the artificial
19 inflation of its revenues and earnings during the fourth quarter
20 of Fiscal 1999.

21 **GAAP VIOLATIONS**

22 53. SEC Regulation S-X (17 C.F.R. §210.4-01(a)(1)) provides
23 that financial statements filed with the SEC which are not
24 prepared in compliance with GAAP are presumed to be misleading
25 and inaccurate, despite footnote or other disclosure. Regulation
26 S-X requires that interim financial statements must also comply
27 with GAAP, with the exception that interim financial statements
28 need not include disclosure which would be duplicative of

1 disclosures accompanying annual financial statements. 17 C.F.R.
2 §210.10-01(a). The responsibility for preparing financial
3 statements that conform to GAAP rests with corporate management
4 as set forth in Section 110.02 of the AICPA Professional
5 Standards:

6 The financial statements are management's
7 responsibility. . . . Management is responsible
8 *for adopting sound accounting policies and for*
9 *establishing and maintaining internal control* that
10 will, among other things, record, process,
11 summarize, and report transactions (as well as
12 events and conditions) consistent with
13 management's assertions embodied in the financial
14 statements. The entity's transactions and the
15 related assets, liabilities, and equity are within
16 the direct knowledge and control of management. .
17 . . Thus, the fair presentation of financial
18 statements in conformity with [GAAP] is an
19 implicit and integral part of management's
20 responsibility.

21 54. Pursuant to these requirements, Legato represented in
22 its quarterly reports on Forms 10-Q for the quarters ended March
23 31, June 30, and September 30, 1999, filed with the SEC during
24 the Class Period, that its financial results were presented
25 appropriately, in accordance with GAAP:

26 In the opinion of management, the
27 accompanying unaudited condensed consolidated
28 financial statements contain all adjustments
29 (all of which are normal and recurring in
30 nature) necessary to present fairly the
31 financial position, results of operations and
32 cash flows of Legato Systems, Inc. and its
33 subsidiaries.

34 55. Despite these assurances, Legato inflated its revenues
35 and net income during the Class Period by improperly recognizing
36 revenue on the types of transactions set forth in ¶¶37-52, above.
37 AICPA Statement of Position ("SOP") 97-2, entitled Software
38 Revenue Recognition, which governs the accounting for the product

1 license sales consummated by Legato during the Class Period, sets
2 forth the criteria under which a software vendor is permitted to
3 recognize revenue derived from software license agreements.
4 Specifically, ¶ .08 of SOP 97-2 precludes recognition of revenue
5 from license sales, where the contract "does not require
6 significant production, modification, or customization of
7 software", unless all of the following criteria are met:

- 8 --Persuasive evidence of an arrangement exists.
- 9 --Delivery has occurred.
- 10 --The vendor's fee is fixed or determinable.
- 11 --Collectability is probable (i.e., is likely to occur).

12 56. Each of these requirements for revenue recognition must
13 be met regardless of whether the software is sold directly to the
14 end-user, or through a reseller. For example, ¶ .18 of this SOP
15 expressly provides that the delivery requirement "applies whether
16 the customer is a user or a reseller." Further, SOP 97-2
17 expressly precludes recognition of revenue from product license
18 sales to resellers where the fee is not fixed and determinable,
19 or collectability is not likely to occur. In such circumstances,
20 the sale to the reseller is not final but, in reality, is
21 contingent upon the reseller's subsequent sale of the product to
22 the end-user.

23 57. Thus, ¶ .30 of SOP 97-2 requires consideration of the
24 following factors, among others, to evaluate whether product
25 license sales to resellers are legitimate, final sales, and
26 recognition of revenue from the agreement is appropriate:

- 27 i. Business practices, the reseller's
28 operating history, competitive pressures,
informal communications, or other factors

1 indicate that payment is substantially
2 contingent on the reseller's success in
distributing individual units of the product.

3 ii. Resellers are new, undercapitalized, or
4 in financial difficulty and may not
demonstrate an ability to honor a commitment
5 to make fixed or determinable payments until
they collect cash from their customers.

6 iii. Uncertainties about the potential
7 number of copies to be sold by the reseller
may indicate that the amount of future
8 returns cannot be reasonably estimated on
9 delivery; examples of such factors include
the newness of the product or marketing
10 channel, competitive products, or dependence
on the market potential of another product
offered (or anticipated to be offered) by the
reseller.

11 iv. Distribution arrangements with resellers
12 require the vendor to rebate or credit a
portion of the original fee if the vendor
13 subsequently reduces its price for a product
and the reseller still has rights with
14 respect to that product (sometimes referred
to as price protection) . . .

15 58. As detailed above, defendants knowingly or with
16 deliberate recklessness caused Legato to recognize revenue from
17 sales to both resellers and end-users where one or more
18 conditions for proper recognition of revenue under GAAP were
19 never met, including the following: (i) the product was never
20 delivered to the purchaser; (ii) the purchaser's obligation to
21 pay for the product was not fixed and determinable; (iii)
22 collectability of the fee was not probable; or (iv) the
23 reseller's obligation to pay for the product was contingent upon
24 subsequent sale of the product to the end-user.

25 59. As detailed in ¶¶37-52, above, Legato employed a
26 variety of means to incentivize its customers to enter into these
27 transactions, including the following: (i) providing cash
28

1 payments or substantial extensions of credit to resellers; (ii)
2 agreeing to transfer the reseller's obligation to purchase the
3 products to another reseller if an end-user did not materialize
4 by the time payment was due; (iii) agreeing to find an end-user
5 for products already delivered to resellers, to provide a means
6 for the reseller to make payment to Legato; (iv) providing
7 resellers with "return and rotation" rights to subvert Legato's
8 internal requirement that sales to resellers be conditioned upon
9 a purchase commitment from an identified end-user; and (v)
10 agreeing to purchase equivalent volumes of products from end-
11 users in return for their agreement to purchase identical sums in
12 Legato products.

13 60. As detailed in ¶¶37-47, above, defendants sought to
14 hide these terms from Legato's auditors by entering into multiple
15 agreements with respect to each product license sale: (i) a
16 primary contract, which provided for the reseller to take
17 delivery of the product, make payment within thirty days, and
18 providing no right of return; and (ii) a verbal or written side
19 agreement, which included one or more of the terms set forth in
20 ¶59, above, designed to make the sale of the product contingent
21 upon performance of additional obligations.

22 61. Further, Legato's ultimate disclosure that it would
23 restate its previously reported financial results during the
24 Class Period constitutes an admission that each of these
25 statements, as included in the Company's press releases and Forms
26 10-Q, were materially false and misleading when issued. Indeed,
27 under Statement of Financial Accounting Standards No. 16, Prior
28 Period Adjustments, restatements are only permitted -- and are

1 required -- for material accounting errors or irregularities.

2 Section 316 of the American Institute of Certified Public

3 Accountant's Codification of Statements on Auditing Standards

4 defines accounting irregularities as

5 intentional misstatements or omissions of
6 amounts or disclosures in financial
7 statements. Irregularities include
8 fraudulent financial reporting undertaken to
9 render statements misleading, sometimes
10 called management fraud. . . . Irregularities
11 may involve acts such as the following:
12 manipulation, falsification, or alteration of
13 accounting records or supporting documents
14 from which financial statements are prepared;
15 misrepresentations or intentional omission of
16 events, transactions, or other significant
17 information; intentional misapplication of
18 accounting principles relating to amounts,
19 classification, manner of presentation, or
20 disclosure.

21 62. Legato's announced restatement confirms that the
22 Company's financial results for the first three quarters of
23 Fiscal 1999 were materially false and misleading when
24 disseminated.

25 **THE FALSE STATEMENTS DISSEMINATED DURING**
26 **THE CLASS PERIOD**

27 Q1 1999

28 63. On April 21, 1999, after the market closed, Legato
announced its results for the first quarter, ended March 31,
1999, reporting "record" revenues of \$48.3 million, and net
income of \$10.1 million. In this press release, Wise described
the recently completed quarter as "the strongest quarter in
company history," while Cole stated "[t]he momentum of the
company has never been stronger, and our growth reflects broad
customer acceptance."

1 64. On or about May 10, 1999, Legato filed with the SEC its
2 Form 10-Q for the quarter ended March 31, 1999. The Form 10-Q
3 reported Legato's false financial results for the quarter, which
4 were materially overstated as described in ¶4, above. The Form
5 10-Q was signed by Wise, and approved by Cole.

6 65. The Form 10-Q also highlighted the growth in the
7 Company's high margin product license sales, which it attributed
8 to its success in penetrating the market for enterprise-wide
9 product licenses:

10 Product license revenue was \$30.5 million in
11 the first quarter of 1999 and \$17.5 million
12 in the first quarter of 1998. Product
13 license revenue increased 74 percent from the
14 first quarter of 1998 to first quarter of
15 1999 primarily as a result of the continued
16 acceptance of our products and increased
17 product sales to large-scale enterprises.

18 66. Legato has now admitted that its publicly reported
19 results for the first quarter of Fiscal 1999 were false. The
20 Company's reported revenues and net income were overstated by
21 \$8.4 million and \$5.4 million, respectively, for the reasons
22 detailed in ¶¶37-40, 58-60, above. If Legato's financial results
23 had been reported accurately for the quarter, the Company would
24 have been forced to reveal that net income had declined by nearly
25 47% from the same period of the prior year, from \$5.195 million
26 to \$2.76 million.

27 67. Legato and its senior officers, Cole and Wise, knew
28 that the Company was reporting false financial results during
this period and that, instead of reaching "record" revenue
levels, as represented in the April 21, 1999 press release,
Legato's revenues actually declined between the fourth quarter of

1 Fiscal 1998 and the first quarter of Fiscal 1999. Indeed, by at
2 least March 1999, Wise and Cole knew from information presented
3 by sales personnel at the weekly executive management meetings
4 that the Company would fall short of revenue and earnings
5 expectations for the first quarter, based, among other things, on
6 its inability to close the IRS Transaction and the Dow Industrial
7 Transaction described in ¶¶37-40, above. Cole and Wise also were
8 concerned that the announcement of an earnings shortfall in the
9 first quarter would cause Legato's stock price to fall,
10 jeopardizing the recently announced Intelliguard acquisition
11 described in ¶29(c), above, and impairing the Company's ability
12 to make other acquisitions for stock.

13 68. Rather than risk a substantial decline in the market
14 price of Legato stock, Cole and Wise authorized the use of
15 improper side agreements and other incentives to induce certain
16 resellers to "close" transactions before the end of the quarter.
17 This included booking \$1.9 million in revenue from the product
18 license transactions involving the IRS and Dow Industrial
19 Transactions, discussed in ¶¶37-40, above, despite the fact that
20 neither customer had committed to purchase these products and no
21 products were ever shipped or delivered to these customers during
22 the first quarter of Fiscal 1999.

23 69. Following the release of the Company's false results
24 for the first quarter, securities analysts issued reports on
25 Legato which were based on and repeated the false financial
26 information provided by Legato's senior management. For example,
27 on April 22, 1999, Hoak Breedlove issued a report in which it
28 recommended the purchase of Legato stock following "what we judge

1 to have been the best conference call ever held by the Legato
2 senior management." In its report, Hoak Breedlove rated Legato
3 stock a "Strong Buy" based largely upon the Company's
4 representations that its first quarter results represented
5 increased penetration of the market for large, high-margin
6 enterprise license agreements contributing \$250,000 or more to
7 annual revenues, including the IRS and Dow Industrial
8 transactions described above:

9 Legato had the following large deal content
10 in 1Q99, which was up 15% sequentially in
11 unit count from 4Q98: 100 over \$100,000; 30
12 over \$250,000; of which "more than a handful"
13 [we estimate 6] over \$1 million - this total
14 calculates to an estimate of more than \$15
15 million of revenues.

16 * * *

17 Conclusion: Legato has already begun to
18 demonstrate contract value growth, even
19 before the inclusion of the products just
20 acquired from the just completed FullTime and
21 Intelliguard transactions.

22 70. Other analysts echoed the positive reaction to Legato's
23 reported first quarter earnings found in the Hoak Breedlove
24 report. For example, in a report dated April 22, 1999, the
25 investment firm CIBC Oppenheimer recommended the purchase of
26 Legato common stock, based largely upon the Company's purported
27 success in obtaining large, high-margin enterprise contracts
28 during the first quarter:

29 The enterprise story is working as large
30 deals (those over \$250,000) accounted for 25%
31 of revenue. These deals are being generated
32 through direct and high-end indirect channel
33 partners.

34 * * *

1 The operating margin improved to 32% in the
2 quarter, significantly ahead of our estimate
3 of 29% due to the stronger than expected
4 license growth. The upside surprise on
5 licenses improved the gross margin to 88% vs.
6 our expectation of 87% due to the higher
7 margin nature of license revenues.

8 71. Similarly, the investment firm Hambrecht & Quist issued
9 a report on or about April 22, 1999, in which it also applauded
10 Legato's ability to win large contracts, noting that "[t]he
11 Company had 100 sales over \$100,000, 30 transactions over
12 \$250,000, and several deals over \$1M." In a report dated April
13 22, 1999, BancBoston Robertson Stephens analyst John Powers
14 commented:

15 Strong growth in enterprise license
16 agreements indicated the success of Legato in
17 providing an integrated storage management
18 solution to large customers. 60% of revenue
19 came from transactions larger than \$250K with
20 several multi-million dollar deals. The fact
21 is key to realizing Legato's clear
22 competitive advantage in large multi-platform
23 (UNIX and NT) deals . . .

24 72. The price of Legato common stock began to rise
25 significantly following the release of the Company's first
26 quarter financial results. On the first day of the Class Period,
27 April 22, 1999, the first day of trading following the Company's
28 first quarter Fiscal 1999 earnings announcement, the price of
Legato common stock rose by approximately 25% from its price one
day prior to the announcement to close at \$44.125 per share. The
stock continued to rise during the second quarter, providing the
means for Legato to make strategic acquisitions in exchange for
Legato stock. For example, on June 8, 1999, Legato announced
that it had agreed to acquire Vinca Corp., a provider of data

1 availability solutions for workgroup environments, in exchange
2 for \$18 million in cash and \$76 million in Legato common stock.

3 Q2 1999

4 73. Legato's management continued to assure the investment
5 community during the second quarter of Fiscal 1999 that the
6 Company's business remained strong, and that it would report
7 sequential growth in revenue and favorable earnings results. On
8 May 24, 1999, Robertson Stephens issued a report in which it
9 upgraded its rating on Legato common stock to "Strong Buy" from
10 "Buy", "[b]ased on extensive conversation with company management
11"

12 74. On July 21, 1999, Legato announced its results for the
13 second quarter ended June 30, 1999, reporting "record" revenues
14 of \$62 million and net income of \$12.5 million. In the Company's
15 press release, Wise again described the second quarter as "our
16 strongest quarter in company history," while Cole stated that
17 Legato's second quarter results "are a direct reflection of the
18 strong momentum we are seeing in our business as customers
19 continue to demand fully-integrated software solutions to support
20 their complex storage environments."

21 75. On or about August 12, 1999, Legato filed with the SEC
22 its Form 10-Q for the quarter ended June 30, 1999. The Form 10-Q
23 reported Legato's false financial results for the quarter which
24 were materially overstated as described in ¶4, above. The Form
25 10-Q was signed by Wise, and approved by Cole.

26 76. In addition to containing false financial results for
27 the quarter, the Form 10-Q also highlighted the growth in the
28 Company's high margin product license sales, which Legato

1 attributed to its continuing success in penetrating the market
2 for enterprise-wide product licenses:

3 Product license revenue was \$41.2 million in
4 the second quarter of 1999 and \$25.9 million
5 in the second quarter of 1998, representing
6 an increase of 59 percent. Product license
7 revenue was \$74.4 million in the first six
8 months of 1999 and \$47.9 million in the first
9 six months of 1998, representing an increase
10 of 55 percent. The increases were primarily
11 attributable to the continued acceptance of
12 our family of products, expansion of our
13 product lines and increased product sales to
14 large-scale enterprises.

15 77. Legato has now admitted that its publicly reported
16 results for the second quarter were false. The Company's
17 reported revenues and net income were overstated by \$10.4 million
18 and \$5.5 million, respectively. If Legato's financial results
19 had been reported accurately for the quarter, the Company would
20 have been forced to reveal that Legato actually suffered a net
21 loss for the quarter of \$1.093 million.

22 78. Legato and its senior officers, Cole and Wise, knew
23 that the Company was reporting false financial results during
24 this period. Indeed, by at least June 1999, Wise and Cole knew
25 from information presented by sales personnel at the weekly
26 executive management meetings that the Company would fall short
27 of revenue and earnings expectations due to Legato's continued
28 difficulty in securing purchase commitments from end-users on
29 various "big deals," including the MCI/UUNET transaction
30 described in ¶¶42-43, above.

31 79. As in the prior quarter, rather than risk a substantial
32 decline in the market price of Legato stock, Cole and Wise
33 authorized the use of improper side agreements and other

1 inducements to induce certain resellers, including Vanguard and
2 ADS, to "close" product license agreements before the end of the
3 quarter, as described in ¶41, 44, above, despite the fact that no
4 end-user had committed to purchase these products.

5 80. Legato's stock price surged after the Company reported
6 its second quarter results. On July 23, 1999 - two days after
7 the Company issued its materially false and misleading earnings
8 announcement, Legato's common stock closed at a new high of
9 \$80.75 per share, representing an increase of more than 83% above
10 its closing price on the first day of the Class Period. Further,
11 numerous analyst reports recommended investment in Legato, based
12 on its apparent success in securing large, high margin enterprise
13 license agreements. For example, on July 22, 1999, Hoak
14 Breedlove issued an analyst report recommending the purchase of
15 Legato common stock, in which it described Legato's enterprise
16 license agreements as "the major new element and the fastest-
17 growing element in the company's revenue mix for the past seven
18 quarters."

19 81. Similarly, in a report dated July 22, 1999, CIBC World
20 Markets commented on Legato's ability to obtain larger,
21 enterprise-wide contracts in recommending the purchase of Legato
22 stock, and noted that "management said that the number of \$1
23 million deals grew from a 'handful' to 'more than a handful.'" On
24 the same day, Robertson Stephens also issued a report
25 recommending the purchase of Legato common stock, noting that
26 "[s]trong growth in enterprise license agreements indicates the
27 success of Legato in providing an integrated storage management
28 solution to large customers." The Robertson Stephens report

1 stressed the Company's reported increase in product revenues,
2 which "grew sequentially from the prior quarter by an astounding
3 23% to \$46.2 million." In a report issued by Investor's Business
4 Daily on August 16, 1999, David Breiner, an analyst with the
5 investment firm Volpe Brown Whelan & Co., echoed these remarks,
6 commenting that "[t]he Company has proven itself adept in
7 managing and exceeding expectations. It has produced an enviable
8 string of upside surprises in both revenue and earnings."

9 82. Following the release of Legato's materially false and
10 misleading second quarter results, between July 26 and August 24,
11 1999, defendants Wise and Cole sold over 177,000 shares of Legato
12 common stock, at prices approaching its all-time high (adjusting
13 for the 2 for 1 stock split effective August 16), realizing
14 proceeds of \$11.8 million, as detailed in ¶¶108-109, below.

15 Q3 1999

16 83. After the substantial stock sales set forth in ¶82,
17 above, Legato's management continued to assure the investment
18 community that the Company's prospects remained solid for the
19 third quarter of Fiscal 1999. On August 27, 1999, SG Cowen
20 analyst Drew Brosseau issued a report which cited guidance given
21 by management that Legato's third quarter results were in line
22 with expectations:

23 Our mid-quarter check with management
24 suggests the Q3 is shaping up well, with
25 solid prospects for meeting or beating our
26 estimates of \$72MM (+ 67%) in revenues and
27 operating EPS of \$0.15 (vs. \$0.08). July
28 results were strong and the pipelines
continue to grow a solid pace in line with
recent quarters. As described in more detail
below, Legato is benefitting from robust
market demand for storage management
solutions and its expanding product portfolio

1 indication that Legato is dominating sales to larger customers
2 and fulfilling the majority of their storage needs.”

3 86. On or about November 10, 1999, Legato filed with the
4 SEC its Form 10-Q for the quarter ended September 30, 1999. The
5 Form 10-Q reported Legato’s false financial results for the
6 quarter which were materially overstated as described in ¶4,
7 above. The Form 10-Q was signed by defendant Wise, with the
8 approval of defendant Cole. The Form 10-Q also highlighted the
9 growth in the Company’s high margin product license sales, which
10 Legato attributed to its continuing success in penetrating the
11 market for enterprise-wide product licenses:

12 Product license revenue was \$47.6 million in
13 the third quarter of 1999 and \$29.0 million
14 in the third quarter of 1998, representing an
15 increase of 64 percent. Product license
16 revenue was \$122.0 million in the first nine
17 months of 1999 and \$76.9 million in the first
18 nine months of 1998, representing an increase
19 of 59 percent. The increases were primarily
20 attributable to the continued acceptance of
21 our family of products, expansion of our
22 product lines resulting from research and
23 development efforts and integration of
24 products from acquired companies and
25 increased product sales to large-scale
26 enterprises.

27 87. Legato has now admitted that its publicly reported
28 results for the third quarter were false. The Company’s reported
29 revenues and net income were overstated by \$3.8 million and \$2.0
30 million, respectively, for the reasons set forth in ¶¶45-47,
31 above. Rather than the “record” results reported to the market,
32 Legato’s actual revenues were \$67.9 million for the quarter, or
33 at least \$3.7 million less than previously reported. Net income
34 for the quarter of Fiscal 1999 was \$13.6 million, or \$2 million
35 less than previously reported.

1 88. Cole and Wise knew that Legato's reported financial
2 results for the period were materially false. For example, by at
3 least September 1999, Wise and Cole knew from information
4 presented by sales personnel at the weekly executive management
5 meetings that the Company would fall short of revenue and
6 earnings expectations due to Legato's continued difficulty in
7 securing purchase commitments from end-users on various "big
8 deals," including the Air Force Transaction described in ¶¶45-47,
9 above. Nevertheless, Cole and Wise continued to authorize the
10 use of improper side agreements and other incentives to induce
11 its resellers, including Logicon, to "close" these transactions
12 before the end of the quarter, as described in ¶¶15-16, above,
13 despite the fact that no end-user had committed to purchase these
14 products.

15 89. During these weekly executive management meetings, Wise
16 and Cole also learned that many of the reseller transactions
17 booked in earlier quarters had still failed to yield a purchase
18 commitment from the intended end-user, including the Richardson
19 School District transaction described in ¶41, above. Wise and
20 Cole also became concerned that the growing number of unclosed
21 contingent deals with resellers had caused the Company's DSOs to
22 increase significantly, which they feared would attract the
23 attention of the auditors. Rather than eliminate the revenues
24 improperly recognized through these transactions, or risk
25 detection by the auditors, Cole directed Wise to prepare the form
26 letter described in ¶15(f), above, providing for each Legato
27 reseller to "acknowledge" that payment terms on these outstanding
28 transactions were net 30 days, and that the products were not

1 returnable to the Company. Although Wise and Cole knew that none
2 of the resellers agreed to sign the form letter, they continue to
3 improperly recognize revenue from these transactions during the
4 third quarter.

5 90. As the price of Legato common stock climbed to record
6 levels following the Company's earnings release, Cole and Wise
7 sold over 115,000 shares of Legato stock in late November 1999,
8 realizing proceeds exceeding \$7.5 million. This insider selling
9 was particularly egregious because it occurred shortly after the
10 "emergency meeting" described in ¶¶15(h), 46-47, above, at which
11 PWC advised Wise and Cole against recognizing revenue on the Air
12 Force transaction during the third quarter.

13 Q4 and Year-End 1999

14 91. On November 11, 1999, Legato convened its annual
15 "Analyst Day" in Redwood City, California, at which securities
16 analysts covering the Company heard presentations from most
17 members of Legato's senior management team, including Wise and
18 Cole. At this meeting, Legato's senior management endorsed
19 prevailing revenue and earnings estimates which were \$90 million
20 and \$0.19 for the fourth quarter and \$275 million and \$0.62 for
21 the full-year, respectively.

22 92. Following Legato's Analyst Day, the price of Legato
23 common stock rose to new all-time highs, closing at \$76.78 per
24 share (split adjusted) on November 17, 1999. On November 18,
25 1999, Legato announced a deal to acquire Ontrack Data
26 International, Inc., in exchange for \$20 million in cash and
27 1.485 million shares of Legato common stock, for total
28 consideration of \$134 million. Cole and Wise knew that a

1 substantial drop in the price of Legato stock would jeopardize
2 the Company's announced acquisition of Ontrack, which was
3 scheduled to close in January 2000.

4 93. In an interview reported by Bloomberg News Service on
5 January 12, 2000, Wise flatly lied about the Company's fourth
6 quarter results, characterizing them as being "within the
7 analysts' expectations" of \$85 to \$90 million in revenues and
8 \$0.19 to \$0.21 in earnings per share:

9 Both in the revenue and earnings range, the
10 Company is within the analysts' expectations.
11 Were we to be outside of this, we would do a
pre-release of our earnings.

12 94. This statement was false when made. At the time this
13 statement was made, Wise knew that the \$10 million SNI
14 transaction booked during the fourth quarter, as described in
15 ¶¶50-51, above, was a sham. Wise also knew that PWC had advised
16 Wise and Cole against recognizing revenue on the Air Force
17 transaction in the third quarter during the emergency meeting
18 described in ¶¶15(h), 46-47, above. Wise also knew or was
19 deliberately reckless in disregarding the fact that, at year-end,
20 PWC would require Legato to restate its third quarter results to
21 reverse the Air Force deal, and would reverse revenue recognition
22 of the SNI deal when it scrutinized its substance. Together,
23 these two deals alone accounted for approximately \$16 million in
24 revenues.

25 95. In early January 2000, auditors from PWC commenced
26 field work for the audit of the Company's Fiscal 1999 results at
27 Legato's headquarters. During this initial field work, the
28 auditors discovered the true substance of the SNI transaction,

1 and informed Legato that revenue could not be recognized on the
2 sale. PWC also reiterated its earlier conclusion that
3 recognition of \$5.8 million in revenue from the Air Force
4 transaction during the third quarter was improper, and that the
5 quarter must be restated to reverse this revenue.

6 96. On January 19, 2000, Legato announced its results for
7 the fourth quarter of Fiscal 1999, reporting revenues of \$71.2
8 million, well below the \$85 to \$90 million range endorsed by Wise
9 just a week earlier. Legato also announced that net income was
10 only \$9.9 million, nearly 90% below prevailing analyst estimates.
11 For the full year, the Company reported net income of \$43 million
12 on revenues of \$251.1 million, falling 9% and 22% below
13 prevailing revenue and earnings expectations of \$275 million and
14 \$55 million, respectively.

15 97. Legato also announced that it would restate its third
16 quarter results to eliminate \$5.8 million in revenue derived from
17 a single, unspecified contract. In the release, Wise stated:

18 During the last few days, in connection with
19 the audit of the Company's 1999 results,
20 Legato was informed by its auditors that one
21 contract recorded as revenue in the third
22 quarter should be recorded as revenue in the
23 first and second quarters of 2000.

24 98. In the same release, Cole attributed both the fourth
25 quarter shortfall and the third quarter restatement to a dispute
26 with Legato's auditors over the appropriate timing of revenue
27 recognition:

28 The shortfall in fourth quarter revenue
resulted primarily from the Company's
determination, in consultation with its
auditors during the last few days in
connection with the 1999 audit, that revenue
from two contracts signed during the fourth

1 quarter should be recognized during 2000.
2 The Company believes that these contracts
3 properly could have been recorded as revenue
4 in the fourth quarter but has elected to
5 implement its auditors' recommendation.

6 99. These statements were false when made. Even with the
7 adjustments, Cole and Wise knew that Legato's financial results
8 for Fiscal 1999 were still overstated by tens of millions of
9 dollars. Wise and Cole knew that, throughout Fiscal 1999, dozens
10 of resellers were given side agreements to induce them to enter
11 into enterprise license transactions, and were given assurance
12 that if these deals could not be finalized with the keyed end-
13 users, they could "rotate and return" the product. Moreover,
14 Wise and Cole knew that resellers had refused to sign Wise's form
15 letter during the third quarter falsely affirming the purported
16 unconditional nature of their obligations. Thus, Wise and Cole
17 knew that revenue recognition on these transactions throughout
18 Fiscal 1999 was improper.

19 100. The market price of Legato common stock plummeted
20 following the January 19, 2000 announcement, falling 45% to close
21 at \$29.75 per share on January 20, 2000, the first trading day
22 following the release. Further, on or about January 24, 2000,
23 Ontrack announced that it had canceled its deal to be acquired by
24 Legato. Legato's stock price rebounded, however, over the course
25 of the following weeks, as the Company issued a series of false
26 assurances to assuage the investment community. For example, in
27 an interview reported by Dow Jones Newswire on January 21, 2000,
28 Cole misleadingly stated that Legato's restatement and purported
deferral of revenues resulted from a decision to adopt "a more
conservative revenue recognition methodology." Similarly, on

1 March 12, 2000, defendants Cole and Wise met with various
2 analysts to reassure them that Legato was "on track" to achieve
3 revenue and earnings growth of at least 50% in Fiscal 2000. The
4 following day, the investment firm Bear Stearns & Co. issued a
5 report recommending the purchase of Legato common stock based
6 upon the prior day's meeting, in which defendants represented
7 that, "[t]he company's revenues during the first two months [of
8 the first quarter of Fiscal 2000] were on target and there has
9 been no trouble seen on the horizon for March."

10 101. These statements sparked a rebound in Legato's stock
11 price. On March 27, 2000, the stock closed at \$45.68 per share,
12 representing an increase of 50% above its closing price of \$29.75
13 per share on January 20 - immediately following the Company's
14 initial disclosure of its third quarter restatement and fourth
15 quarter revenue and earnings shortfall.

16 The Scheme Begins To Unravel

17 102. On April 3, 2000, Legato announced that, in addition to
18 the previously announced restatement of its third quarter Fiscal
19 1999 results, it was revising downward its previously reported
20 results for the fourth quarter and full year Fiscal 1999, because
21 of the Company's use of "side agreements" with resellers. Legato
22 also revealed that it would be unable to timely file its 1999
23 Form 10-K for Fiscal 1999 because its auditors were investigating
24 these transactions:

25 [O]n March 31, 2000, [Legato] filed with the
26 Securities and Exchange Commission a
27 Notification of Late Filing with respect to
28 its Annual Report on Form 10-K for the year
ended December 31, 1999. The Company expects
to file its Form 10-K on or before April 14,
2000.

1 In its notification, the Company reported
2 that it was unable to file its Form 10-K by
3 March 30, 2000 because, based on its regular
4 first quarter review of certain fourth
5 quarter 1999 transactions, it discovered
6 additional information that related to such
7 transactions. The Company has requested that
8 its independent auditors evaluate such
9 transactions in light of this additional
10 information.

11 103. This statement was false. It was not the Company, but
12 rather PWC during its year-end audit, that "discovered" the
13 improprieties associated with these transactions. The
14 announcement also falsely attributed these improprieties to "a
15 small number of its sales representatives, acting outside their
16 authority," who had entered into side agreements involving
17 approximately \$7 million of fourth quarter Fiscal 1999 revenues.
18 The price of Legato common stock plummeted following the April 3,
19 2000 announcement, losing more than 55% of its value to close at
20 \$19.875 per share on that day.

21 104. On April 17, 2000, Legato announced that the filing of
22 its 1999 Form 10-K, and the release of its results for the first
23 quarter of the fiscal year ending December 31, 2000 would be
24 further delayed:

25 While the Company had previously anticipated
26 it would file its 10-K by April 14th, the
27 evaluation of transactions throughout Fiscal
28 1999 by the Company and its independent
auditors has not yet been completed. It is
the Company's objective to complete this
review over the next several weeks. As a
result of its ongoing investigation, the
Company will delay the release of its
financial results and teleconference briefing
for the first quarter of fiscal 2000,
previously scheduled for April 26, 2000,
until it has filed its Form 10-K for fiscal
1999.

1 Three days later, Legato revealed that NASDAQ had initiated
2 delisting procedures due to the Company's failure to file its
3 1999 Form 10-K in a timely manner.

4 105. On May 17, 2000, after the close of trading, Legato
5 finally revealed the magnitude and extent of its restatements for
6 the first three quarters of Fiscal 1999, and the revision of its
7 previously announced results for the fourth quarter and year-end,
8 revealing that previously reported revenues had been overstated
9 by \$23 million:

10 Of the \$23.0 million total net revision in
11 Fiscal 1999 revenue, approximately \$18.2
12 million relates to transactions with
13 resellers where, due to the existence of
14 unauthorized side agreements and verbal
15 promises on certain specific transactions,
16 the Company has determined that the fees from
17 transactions with such resellers are not
18 fixed or determinable. Accordingly, the
19 Company has elected to recognize the revenue
20 from transactions with these resellers when
21 the fees are deemed fixed or determinable,
22 which generally coincides with the receipt of
23 payments from these resellers. The remaining
24 \$4.8 million of revised revenue relates to
25 contracts where subsequent events and
26 additional information required different
27 accounting treatment than adopted at the time
28 the contracts were originally recorded. Of
the total \$23.0 million reduction in fiscal
1999 revenue, the Company believes it will
recognize approximately \$16.0 million during
Fiscal 2000.

106. The Company also revealed that a newly formed "special
committee" of independent directors, consisting of H. Raymond
Bingham and David N. Strohm, after investigating the
circumstances surrounding the misstatement of the Company's
Fiscal 1999 results, had concluded that Legato directors Phillip
E. White and Kevin A. Fong (its only 2 members) should be
dismissed from the Company's Audit Committee, and that neither

1 would be re-elected to the Board. Thereafter, on July 26, 2000,
2 the Company announced that defendant Cole would be relieved of
3 responsibility for managing the day-to-day operations of the
4 Company, and that defendant Wise would be replaced with a new
5 CFO.

6 107. On May 18, 2000, the first day of trading after the
7 Company announced its restated results for Fiscal 1999, the
8 Company's common stock closed at \$11.9375 per share, representing
9 a decline of 85% from its high during the Class Period of \$79.25
10 per share.

11 **INSIDER SELLING**

12 108. Notwithstanding their direct participation in and
13 knowledge of the financial fraud as detailed herein, and their
14 possession of material non-public information about Legato, Cole
15 and Wise sold 357,968 shares of Legato common stock during the
16 Class Period, for proceeds of over \$22.5 million, as set forth
17 below:

	<u>Defendant</u>	<u>Date</u>	<u>Shares Sold</u>	<u>Price</u>	<u>Sale Proceeds</u>
1	Cole	07/26/99	20,000	\$76.42	\$1,528,400.00
2		07/26/99	20,000	\$77.88	\$1,557,600.00
3		07/28/99	20,000	\$76.66	\$1,533,200.00
4		07/29/99	20,000	\$73.28	\$1,465,600.00
5		07/30/99	16,000	\$72.79	\$1,164,640.00
6		08/11/99	10,000	\$68.56	\$ 685,600.00
7		08/12/99	5,000	\$68.81	\$ 344,050.00
8		08/13/99	10,000	\$71.49	\$ 714,900.00
9		08/23/99	30,000	\$41.51	\$1,245,300.00
10		08/24/99	10,000	\$42.44	\$ 424,400.00
11		08/24/99	10,000	\$41.34	\$ 413,400.00
12		11/23/99	30,000	\$64.50	\$1,935,000.00
13		11/24/99	40,000	\$65.05	\$2,602,000.00
14	11/29/99	5,000	\$67.75	\$ 338,750.00	
15	TOTAL		246,000		\$15,952,840.00
16	Wise	07/30/99	12,546	\$72.73	\$ 912,470.58
17		07/30/99	21,000	\$72.82	\$1,529,220.00
18		08/16/99	15,500	\$37.25	\$ 557,375.00
19		08/17/99	18,000	\$38.88	\$ 699,840.00
20		08/17/99	1,000	\$38.88	\$ 38,880.00
21		08/17/99	3,500	\$38.75	\$ 135,625.00
22		11/24/99	5,822	\$65.00	\$ 378,430.00
23		11/24/99	3,600	\$67.00	\$ 241,200.00
24		11/24/99	20,000	\$67.00	\$1,340,000.00
25	11/29/99	11,000	\$66.75	\$ 734,250.00	
26	TOTAL		111,968		\$6,587,290.58
27	GRAND TOTALS:		357,968		\$22,540,130.58

19 109. This insider selling by Cole and Wise was unusual and
20 suspicious, both in timing and amount. The first round of
21 insider sales by Cole and Wise came on the heels of Legato's July
22 21, 1999 press release announcing "record" revenues for the
23 second quarter of Fiscal 1999, which defendants knew was
24 materially false and misleading. Between July 26 and August 24,
25 1999, Cole sold 171,000 shares for proceeds of over \$11 million,
26 and Wise sold over 71,000 shares for proceeds of over \$3.8
27 million.

28 110. The second round of unusual and suspicious insider

1 selling by Cole and Wise came just after Legato filed its Form
2 10-Q for the third quarter of Fiscal 1999, which Cole and Wise
3 knew contained false financial results for the quarter based upon
4 the improper inclusion of revenues from the Air Force
5 transaction, among others, as described in ¶¶49-52, above.
6 Between November 23 and November 29, 2000, Cole sold 75,000
7 shares for proceeds of \$4,875,750, and Wise sold 40,422 shares
8 for proceeds of \$2,693,880. These sales occurred shortly after
9 the November 8, 1999 "emergency meeting" described in ¶¶15(h),
10 46-47, above, at which PWC partner Larry De Bower advised Cole
11 and Wise that recognition of revenue on the Air Force deal in the
12 third quarter was improper.

13 **COUNT I**

14 **AGAINST ALL DEFENDANTS FOR VIOLATIONS OF SECTION 10(b)**
15 **OF THE EXCHANGE ACT AND RULE 10b-5 PROMULGATED THEREUNDER**

16 111. Plaintiffs repeat and reallege each of the allegations
17 set forth in the foregoing paragraphs. This Count is brought
18 pursuant to Section 10(b) of the Exchange Act, and Rule 10b-5
19 promulgated thereunder, on behalf of all purchasers of Legato
20 securities on the open market during the Class Period.

21 112. Throughout the Class Period, Legato, Cole and Wise, by
22 the use and means of instrumentalities of interstate commerce
23 and/or of the mails, made a series of false and misleading
24 statements and omissions, all of which caused the market price of
25 Legato securities to be artificially inflated throughout the
26 Class Period. As detailed herein, defendants' false and
27 misleading statements during the Class Period included the
28 following:

1 (a) The statements contained in each Form 10-Q for
2 Fiscal 1999 filed by Legato with the SEC during the Class Period
3 that, "[i]n the opinion of management, the accompanying unaudited
4 condensed consolidated financial statements contain all
5 adjustments (all of which are normal and recurring in nature)
6 necessary to present fairly the financial position, results of
7 operations and cash flows of Legato Systems, Inc. and its
8 subsidiaries;"

9 (b) The statement contained in each Form 10-Q filed by
10 Legato during the Class Period that the Company "recognize[s]
11 product license revenue upon shipment if a signed contract
12 exists, the fee is fixed and determinable, collection of
13 resulting receivables is probable and product returns are
14 reasonably estimable. . .;"

15 (c) The statements contained in Legato's press
16 release, dated April 21, 1999, and in the Company's Form 10-Q for
17 the first quarter of Fiscal 1999, which was filed with the SEC on
18 or about May 10, 1999, that the Company earned \$10.1 million on
19 revenues of \$48.3 million;

20 (d) The statements contained in Legato's press
21 release, dated July 21, 1999, and in the Company's Form 10-Q for
22 the second quarter of Fiscal 1999, which was filed with the SEC
23 on or about August 12, 1999, that the Company earned \$12.5
24 million, excluding various merger and acquisition costs, on
25 revenues of \$62 million;

26 (e) The statements contained in Legato's press
27 release, dated October 20, 1999, and in the Company's Form 10-Q
28 for the second quarter of Fiscal 1999, which was filed with the

1 SEC on or about November 10, 1999, that the Company earned \$16
2 million, excluding various merger and acquisition costs, on
3 revenues of \$71.7 million;

4 (f) The statement by defendant Wise, as reported by
5 Bloomberg News Service on January 12, 2000 that, for the fourth
6 quarter and full year Fiscal 1999, "[b]oth in the revenue and
7 earnings range, the Company is within the analysts'
8 expectations;"

9 (g) The statements contained in Legato's press
10 release, dated January 19, 2000, that the Company earned \$9.9
11 million, excluding various merger and acquisition costs, on
12 revenues of \$71.2 million; and

13 (h) The statements contained in Legato's press
14 releases dated April 3, 2000 and May 17, 2000, and the Company's
15 Form 10-K for Fiscal 1999, filed with the SEC on or about May 17,
16 2000, that the overstatement of the Company's revenues and
17 earnings during the Class Period was attributable to "a small
18 number of its sales representatives, acting outside their
19 authority. . . ."

20 113. Legato, Cole and Wise acted with scienter throughout
21 the Class Period, in that they had actual knowledge of the
22 misrepresentations and omissions of material facts set forth in
23 ¶¶15-16, above. Specifically, defendant Cole, as Chairman of the
24 Board and CEO of the Company, and Wise, as Senior Vice-President
25 and CFO of Legato, were directly responsible for each of the
26 statements set forth in ¶112, above, as evidenced by their
27 knowledge of and direct involvement in the various improper
28 transactions detailed above.

1 114. Legato, Cole and Wise made and/or participated in the
2 making of the false and misleading statements described in ¶112,
3 above, to inflate the price of Legato securities for the purpose
4 of, among other things: (i) allowing Cole and Wise to recoup
5 millions of dollars in proceeds from the sale of Legato common
6 stock at artificially inflated prices; and (ii) allowing Legato
7 to use its stock as currency to make various significant business
8 acquisitions.

9 115. As a result of these deceptive practices and false and
10 misleading statements and omissions, the market price of Legato
11 securities was artificially inflated during the Class Period. In
12 ignorance of the false and misleading nature of the
13 representations and omissions described above and the deceptive
14 and manipulative devices employed by the defendants, plaintiffs
15 and the other members of the Class, in reliance on either the
16 integrity of the market or directly on the statements and reports
17 of defendants, purchased Legato securities at artificially
18 inflated prices.

19 116. Had plaintiffs and the other members of the Class known
20 of the material adverse information not disclosed by defendants,
21 or been aware of the truth behind defendants' material
22 misstatements, they would not have purchased Legato securities at
23 artificially inflated prices.

24 117. By virtue of the foregoing, defendants named in this
25 Count have violated Section 10(b) of the Exchange Act and Rule
26 10b-5 promulgated thereunder.

1 COUNT II

2 AGAINST THE INDIVIDUAL DEFENDANTS FOR
3 VIOLATIONS UNDER SECTION 20(a) OF THE EXCHANGE ACT

4 118. Plaintiffs repeat and reallege each of the allegations
5 set forth in the foregoing paragraphs. This Count is brought
6 pursuant to Section 20(a) of the Exchange Act on behalf of all
7 purchasers of Legato securities on the open market during the
8 Class Period.

9 119. Each of the Individual Defendants was a controlling
10 person of the Company within the meaning of Section 20(a) of the
11 Exchange Act during the Class Period. Specifically,
12 throughout the Class Period, each of the Individual Defendants
13 had the power and authority to cause the Company to engage in the
14 wrongful conduct complained of herein by reason of the following:

15 (a) Defendant Cole had the power and authority to
16 cause Legato to engage in the wrongful conduct complained of
17 herein by virtue of his positions as Chairman of the Board and
18 CEO of the Company, and through his substantial ownership of the
19 Company's common stock outstanding; and

20 (b) Defendant Wise had the power and authority to
21 cause Legato to engage in the wrongful conduct complained of
22 herein by virtue of his positions as Senior Vice President and
23 CFO of the Company.

24 120. By reason of their positions of control over the
25 Company, as alleged herein, each of the Individual Defendants is
26 liable jointly and severally with and to the same extent that
27 Legato is liable to plaintiffs and the members of the Class as a
28 result of the wrongful conduct alleged herein.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

PRAYER FOR RELIEF

WHEREFORE, plaintiffs, on behalf of themselves and the members of the Class, pray for judgment as follows:

1. Declaring this action to be a proper class action maintainable pursuant to Rule 23 of the Federal Rules of Civil Procedure and declaring plaintiffs to be proper Class representatives;

2. Awarding plaintiffs and the other members of the Class compensatory damages as a result of the wrongs alleged in Counts I and II of the Complaint;

3. Awarding plaintiffs and the other members of the Class their costs and expenses in this litigation, including reasonable attorneys' fees and experts' fees and other costs and disbursements; and

4. Granting plaintiffs and the other members of the Class such other and further relief as the Court may deem just and proper.

JURY TRIAL DEMANDED

Plaintiffs demand a trial by jury of all issues so triable.

DATED: August 7, 2000

BERNSTEIN LITOWITZ BERGER &
GROSSMANN LLP

By: _____
ALAN SCHULMAN (128661)
ROBERT S. GANS (Pro Hac Vice)
BLAIR A. NICHOLAS (178428)
12730 High Bluff Drive, Suite 100
San Diego, CA 92130
Tel: (858) 793-0070
Fax: (858) 793-0323
-and-

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

DOUGLAS M. McKEIGE
1285 Avenue of the Americas
New York, New York 10019
Tel: (212) 554-1400
Fax: (212) 554-1444

Attorneys for Lead Plaintiff The
Policemen and Firemen Retirement
System of the City of Detroit and
Lead Counsel for the Class

Paul F. Bennett
Steven O. Sidener
Joseph M. Barton
GOLD BENNETT CERA & SIDENER LLP
595 Market Street, Suite 2300
San Francisco, CA 94105
415/777-2230
415/777-5189 (fax)

Marc I. Gross
Susan R. Schwaiger
POMERANTZ HAUDEK BLOCK GROSSMAN &
GROSS LLP
100 Park Avenue, 26th Floor
New York, NY 10017-5516
212-661-1100
212/661-8665 (fax)

Lee Squitieri
Nancy Kaboolian
ABBEY, GARDY & SQUITIERI, LLP
212 East 39th Street
New York, NY 10016
212/889-3700
212/684-5191 (fax)

Joseph J. Tabacco, Jr.
Ritu Patel
BERMAN, DEVALERIO, PEASE & TABACCO,
P.C.
425 California St., Suite 2025
San Francisco, CA 94104-2205
415/433-3200
415/433-6382 (fax)

Nadeem Faruqi
Lubna Faruqi
FARUQI & FARUQI, LLP
320 East 39th Street,
3rd Floor
New York, NY 10016
212/983-9330
212/983-9331 (fax)

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Deborah R. Gross
LAW OFFICES OF BERNARD GROSS
Sixth Floor
1500 Walnut Street
Philadelphia, PA 19102
215/561-3600
215/561-3000 (fax)

Marc S. Henzel
MARC HENZEL, ESQUIRE
210 West Washington Square
Third Floor
Philadelphia, PA 19106
215/625-9999
215/440-9475 (fax)

David Jaroslawicz
JAROSLAWICZ & JAROS
150 William Street,
19th Floor
New York, NY 10038
212/227-2780
212/732-6746 (fax)

Ann White
LIEBENBERG & WHITE
The Pavilion
261 Old York Road
Suite 810
Jenkintown, PA 19046
215/481-0272
215/481-0271 (fax)

Klari Neuwelt
LAW OFFICE OF KLARI NEUWELT
110 East 59th Street
29th Floor
New York, NY 10022
212/593-8800
212/593-9131 (fax)

Andrew M. Schatz
SCHATZ & NOBEL, PC
330 Main Street
Hartford, CT 06106-1817
860/493-6292
860/493-6290 (fax)

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Curtis V. Trinko
Timothy McFall
LAW OFFICES OF
CURTIS V. TRINKO LLP
16 West 46th Street
Seventh Floor
New York, NY 10036
212/490-9550
212/986-0158 (fax)

Fred Taylor Isquith
Shane T. Rowley
WOLF HALDENSTEIN ADLER FREEMAN &
HERZ, LLP
270 Madison Avenue
New York, NY 10016
212/545-4600
212/545-4653 (fax)

Robert S. Schachter
Richard A. Speirs
ZWERLING, SCHACHTER & ZWERLING, LLP
767 Third Avenue
New York, NY 10017-2023
212/223-3900
212/371-5969 (fax)

Alan Fenster
THE LAW OFFICES OF ALAN FENSTER
9777 Wilshire Blvd.
Suite 900
Beverly Hills, CA 90212
310/273-3661
310/273-1931 (fax)

Attorneys for Plaintiffs

38821