

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO**

Civil Action No. 00-RB-1864 (BNB) (consolidated with Civil Action Nos. 00-RB-1908, 00-RB-1910, 00-RB-1919, 00-RB-1945, 00-RB-1954, 00-RB-1957, 00-RB-1963, 00-RB-1996, 00-RB-2040, 00-RB-2074, 00-RB-2149, 00-RB-2243, and 00-RB-2316)

In re ICG COMMUNICATIONS, INC. SECURITIES LITIGATION

This Document Relates To: All Actions

SECOND CONSOLIDATED AND AMENDED COMPLAINT

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NATURE OF THE ACTION

1. Lead Plaintiffs Strategic Market Analysis Fund, Retirement Systems of Alabama,¹ and the Policemen's Annuity and Benefit Fund, City of Chicago (collectively "Lead Plaintiffs"), on behalf of themselves and all others similarly situated, allege the following upon knowledge with respect to their own acts and upon facts obtained through an investigation conducted by their counsel.

2. Throughout the Class Period, ICG Communications, Inc. ("ICG" or the "Company") represented itself to be one of the largest and fastest growing competitive local exchange carriers ("CLECs") in the United States, providing telecommunications services to Internet Service Providers ("ISPs") and small and mid-sized businesses. As a CLEC, Wall Street measured ICG's success by "line count" (the number of revenue-producing lines the Company had installed) and the revenues reported by ICG from those lines. During the Class Period, ICG reported tremendous growth, both in the number of lines installed in its network and in revenues earned. The Company's 1999 Form 10-K, which the Company filed with the Securities and Exchange Commission ("SEC") on March 30, 2000, reported that revenues had tripled to \$479.2 million in 1999 from \$149.9 million in 1997 and that it had installed a "record" 133,000 net business lines and ISP ports during the fourth quarter of 1999.

3. Wall Street responded to ICG's reported success by raising the valuation of the Company's stock and providing the Company with over \$1 billion

¹ The Retirement Systems of Alabama is the same entity that was referred to as the Alabama Retirement Systems in the Consolidated and Amended Complaint filed February 15, 2002.

in private capital. What the investing public could never imagine was that ICG's line counts – the primary metric supporting the rise in ICG's stock price beginning in the fourth quarter of 1999 – were fundamentally falsified and that just over six months after the \$1 billion in new capital was announced, the Company would be forced to file for Chapter 11 bankruptcy protection and de-listed from trading by the NASDAQ.

4. The dramatic rise and precipitous fall of ICG was squarely the result of the fraudulent conduct of two of ICG's top corporate executives, Defendant J. Shelby Bryan ("Bryan") and Defendant William S. Beans ("Beans"). Recognizing the opportunity and promise offered by the fast-rising Internet industry, Defendant Bryan oversaw ICG's fundamental shift away from ICG's roots as a traditional local phone service provider and into the business of providing network services to Internet Service Providers ("ISPs") and other third parties seeking to transmit not only telephone-based voice data, but also video and the other complex data comprising Internet-based communications.

5. In order to successfully implement this strategy: (1) ICG needed hundreds of millions of dollars in capital to build a new network capable of handling more complex data transmission; (2) ICG therefore needed higher stock valuations to provide it with ready access to the capital markets; (3) ICG needed ISPs and other third parties to purchase hundreds of thousands of communications lines giving them access to ICG's network; and (4) ICG needed its network to provide

ISPs with reliable service so that the lines sold to those ISPs could generate actual revenue.

6. As part of ICG's efforts to achieve this aggressive transformation from a typical CLEC to a leader in the Internet market, in July 1999, ICG brought Defendant Beans to the Company. Bryan and Beans quickly recognized that the key to ICG's access to private and public capital was to aggressively grow the Company's line count and revenues, and thereby increase the Company's stock valuation. To the detriment of thousands of investors, however, Bryan's and Beans' desire to portray ICG as a leader in the ISP network services industry came at the expense of the truth. Unable to legitimately achieve ICG's transformation as quickly as the Company's financial circumstances required, Bryan and Beans artificially inflated line counts and improperly booked reciprocal compensation revenue.

7. Specifically, from the time Beans joined the Company, Bryan and Beans conducted monthly and, in the case of Beans, weekly "executive meetings" at which the Company's entire focus shifted away from developing the core business and instead to meeting Wall Street's expectations for "line counts." As Lead Plaintiffs learned directly from high-ranking former ICG employees who attended these meetings, Bryan and Beans stayed intimately involved and aware of ICG's line counts and its ability to meet Wall Street's ever-growing expectations. When it became clear to Bryan and Beans in December 1999 that ICG would not meet Wall Street's projections, Bryan and Beans specifically instructed their staff to

use a variety of methods to falsely inflate ICG's reported revenue-producing line counts. Bryan and Beans continued to direct and require the use of these practices through the first and second quarters of 2000.

8. As detailed below in ¶ 85 to 129, ***individuals who were directly and indirectly instructed by Defendants Bryan and Beans*** to falsify ICG's line counts have explained that Bryan and Beans were specific in the methods they wanted their employees to follow in achieving this fraud. Among other things, Defendants Bryan and Beans directed ICG personnel to artificially boost ICG's line counts in the following ways:

- a. by pushing customers to buy more lines than they needed by offering heavy discounts, delayed billing, and even offering free lines, but booking all lines sold under these programs as current and full revenue producing lines;
- b. by ignoring customers' line cancellations in current quarters and choosing to recognize such cancellations only in future quarters when ICG would otherwise meet Wall Street's line count expectations; and
- c. by adding various types of non-revenue-producing lines, and reporting revenue on these lines, into ICG's DTOTS database.

9. Lead Plaintiffs' extensive investigation discovered that, pursuant to the orders of Defendants Bryan and Beans, ICG in fact fraudulently inflated its publicly reported line counts, among other ways, by falsely counting the following types of non-revenue-producing lines: (1) non-billable lines; (2) cancelled and "double-billed" lines; (3) internal lines; (4) uninstalled lines; (5) non-existent lines (*i.e.* 169,000 lines being billed to a switch with an 84,000 line maximum capacity); (6) "in" lines; and (7) ISP "free" lines. As detailed in paragraphs 87 to 129,

numerous upper-level and mid-level ICG employees have confirmed and provided specific instances in which Bryan and Beans actually caused ICG to inflate its line count through these methods in the fourth quarter of 1999 and the first and second quarters of 2000.

10. Bryan's and Beans' desire to meet Wall Street's line count expectations, however, faced an insurmountable hurdle—ICG's failing network. Because the ISPs were purchasing lines from ICG to gain access to ICG's network, it was imperative for the success of ICG's new business plan that the network properly function. That network, however, was failing for much of 1999 and into 2000.

11. Bryan and Beans, both of whom specifically knew about the problems with ICG's network and the customer complaints these defects caused, recognized that if they disclosed these network problems investors would quickly realize that ICG could not sustain its reported rapid line count growth. Instead, they omitted reference to the network problems in ICG's public statements and falsely stated that its network was state-of-the-art. Bryan and Beans hoped that with an inflated stock price and an infusion of capital, they could somehow buy the time to allow the reality of ICG's network operations and concomitant line sales to "catch up" to the fiction they were portraying to the investing public.

12. For a while, Defendants' plan appeared to be working. As a direct result of their fraudulent conduct, during the first two months of 2000, ICG was able to secure over \$1 billion in capital investment. The Company also continued

to falsely represent increasing line installations and corresponding revenue during the first and second quarters of 2000, ended on March 31, 2000 and June 30, 2000, respectively. Indeed, on April 26, 2000, ICG announced its results for the first quarter ended March 31, 2000, reporting “record” line installations and revenues of \$157.2 million, an increase of 51% over the comparable period in 1999. On August 10, 2000, ICG announced its results for the second quarter ended June 30, 2000, again reporting increased line installations and revenues. The following charts demonstrate the purported growth of: (1) ICG’s customer service lines; and (2) ICG’s local services revenue, which was derived from providing local and data services to business customers, and providing network facilities and data management to ISP customers:

ICG’s PURPORTED LINE INSTALLATIONS

	Net Line Adds	Total Access Lines
Q1 1999, ended 03/31/99	64,000	419,000
Q2 1999, ended 06/30/99	76,000	494,000
Q3 1999, ended 09/30/99	90,000	585,000
Q4 1999, ended 12/31/99	133,000	731,000
Q1 2000, ended 03/31/00	174,000	905,000
Q2 2000, ended 06/30/00	208,000	1,100,000

ICG's REPORTED REVENUES (in thousand of dollars)

	Local Services	Total Revenues	Local Service Revenue As % of Total Revenues
1998 Year-End	159,197	303,317	52.4%
Q1 1999, ended 03/31/99	67,399	104,331	64.6%
Q2 1999, ended 06/30/99	76,770	117,654	65.2%
Q3 1999, ended 09/30/99	69,454	115,166	60.3%
Q4 1999, ended 12/31/99	86,318	142,075	60.7%
Fiscal 1999	299,941	479,226	62.5%
Q1 2000, ended 03/31/00	102,595	157,224	65.2%
Q2 2000, ended 06/30/00	127,502	175,753	72.5%

13. On a parallel track, Defendants Bryan and Beans employed another fraudulent scheme to inflate ICG's revenue from what was left of its original phone services business. During the Class Period, ICG attributed a large percentage of its reported revenue to "reciprocal compensation" allegedly owed to ICG by Regional Bell Operating Company's ("RBOCs") or incumbent local exchange carriers ("ILECs") for the transport and termination of local traffic to ISPs from RBOC/ILEC customers pursuant to various interconnect agreements.

According to Cindy Schonhaut, the Company's Executive Vice President of Governmental Affairs, Defendants Bryan and Beans knew, or should have known, that ICG was improperly booking reciprocal compensation revenue in 1999 and 2000. In a series of internal company memoranda dated in 1998, 1999 and 2000, Schonhaut documented her opinion that ICG should not be recognizing revenue from reciprocal compensation agreements because it was extremely unlikely that such revenue would ever be collected. ***Defendants Bryan and Beans, as well as various ICG Vice Presidents, received all of her memoranda.*** Despite these memorandums, Beans and Bryan continued to include the reciprocal compensation as revenue.

14. ***As confirmed by numerous witness accounts detailed below,*** throughout the first two quarters of 2000, Defendants Bryan and Beans continued to conduct their weekly and monthly "executive meetings," where methods for inflating ICG's line count were specifically hatched, and they continued to oversee, and require, the knowing falsification of ICG's publicly-reported line counts. It was not long, however, before the network issues and customer line (and later contract) cancellations became too significant for Bryan and Beans to hide.

15. Bryan's and Beans' fraudulent scheme came to a crashing halt in August 2000, when, as a result of the Company's failing network and absence of meaningful customer service, major ISP customers began canceling their line use contracts. As a result, ICG no longer could continue to report massive sales of lines, real or otherwise, to Wall Street. Accordingly, during a conference call for

analysts and investors announcing its second quarter 2000 results on August 10, 2000, ICG partially disclosed the fact that its business was not operating as successfully as previously represented, disclosing lower than expected second quarter results, lowering the Company's expectations for the second half of 2000 and all of 2001. On that day, ICG also announced the sudden resignation of Pamela Jacobson, the Company's Executive Vice President of Sales and Marketing.

16. Following these announcements, ICG's common stock price plummeted, falling $\$7 \frac{11}{16}$ to $\$6 \frac{9}{16}$, or 54%, with more than 25.4 million shares being traded – more than 36 times the stock's three-month average.

17. Then, on August 22, 2000, ICG announced that Bryan had resigned his position as Chairman and CEO. The Company's Board of Directors elected Carl Vogel ("Vogel") to replace Bryan. Vogel, a Senior Vice President of Liberty Media, became a Director of the Company in April 2000 after Liberty Media's \$500 million investment in the Company.

18. On September 18, 2000, after ICG belatedly revealed some of the problems with its network and resultant customer complaints, and stated that it anticipated "significantly lower line installations" in the future, the price of ICG's common stock fell \$2.25, or 58%, to \$1.66 per share, on volume of 23 million shares exchanged, more than 11 times the three-month daily average. The closing price of ICG common stock following these announcements represented a

42% decrease from the previous day's closing price and a 95% decrease from the Class Period high of \$39.00 per share on March 27, 2000.

19. The next day, September 19, 2000, Vogel resigned. Board members Gary Howard, Executive Vice President and Chief Operating Officer of Liberty Media, and Thomas Hicks, Chairman and CEO of Hicks, Muse, Tate & Furst, who had also joined the Company's Board in connection with the \$750 million investment in the Company only months before, also resigned.

20. Shortly thereafter, on November 14, 2000, the Company filed for Chapter 11 bankruptcy protection. On November 18, 2000, ICG's stock was delisted by NASDAQ.

JURISDICTION AND VENUE

21. The claims asserted herein arise under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §§78j(b) and 78t(a), and Rule 10b-5, 17 C.F.R. §240.10b-5, promulgated thereunder.

22. This Court has jurisdiction over the subject matter of this action pursuant to Section 27 of the Exchange Act, 15 U.S.C. §78aa, and 28 U.S.C. §§1331 and 1337.

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

executive offices in this District at 161 Inverness Drive West, Englewood, Colorado.

24. In connection with the acts, conduct and other wrongs complained of herein, Defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, the United States mails, and the facilities of a national securities market.

PARTIES

25. The first filed action in this consolidated action was filed by Plaintiff David Rabbach on September 22, 2000. Additional actions were initiated by Plaintiffs Leslie Westreich, Geoffrey Meadows, Harold Barons, Jerry Krim, John Rakoci, Christian Koerner, James C. Graham, Mitch Gilbert, Constance M. Bennett, Kelly L. Hopfensperger, LSP Partners, L.P., Richard F. Lewis and Steve Lasser, all of whom purchased ICG common stock during the Class Period at prices which were vastly inflated as a result of Defendants' fraudulent statements.

26. By Order dated October 25, 2001, the Strategic Market Analysis Fund ("Strategic Market"), Retirement Systems of Alabama ("RSA"), and the Policemen's Annuity and Benefit Fund, City of Chicago ("Chicago Police") (collectively "Lead Plaintiffs") were appointed Lead Plaintiffs for the Class pursuant to Section 21D(a)(3)(B) of the Exchange Act, and the Lead Plaintiffs file this Second Consolidated and Amended Class Action Complaint in their capacity as Court-appointed Lead Plaintiffs.

27. Plaintiff Strategic Market is a private investment fund. During the Class Period, Strategic Market purchased 1,902,700 shares of ICG common stock in the open market.

28. Plaintiff RSA consists primarily of three jointly administered retirement systems, the Teachers' Retirement System, the Employees' Retirement System and the Judicial Retirement Fund, and is organized for the benefit of retired employees of the State of Alabama. RSA has total assets under management of over \$24 billion for the benefit of over 290,000 active and retired members. During the Class Period, RSA purchased 412,500 shares of ICG common stock in the open market.

29. Plaintiff Chicago Police is organized for the benefit of retired police officers of the city of Chicago and has total assets under management of over \$3.4 billion. During the Class Period, Chicago Police purchased 423,500 shares of ICG common stock in the open market.

30. At the time Lead Plaintiffs acquired ICG common stock, they were each without knowledge of the facts concerning the inaccurate and misleading financial results contained in ICG's public filings with the SEC and have sustained substantial damage as a direct and proximate result of Defendants' violations of federal securities laws.

31. ICG was incorporated in Delaware and maintained its principal place of business at 161 Inverness Drive West, Englewood, Colorado. On November 14, 2000, ICG and certain of its direct and indirect subsidiaries filed

voluntary petitions for reorganization under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. ICG's Modified Plan of Reorganization was approved by the Bankruptcy Court on October 10, 2002, and its liabilities related to claims including those contained herein were discharged in accordance with the Bankruptcy Code. ICG would be named as a defendant herein but for the discharge included in the Modified Plan of Reorganization.

32. Defendant J. Shelby Bryan served as ICG's President from May 1995 until June 10, 1999, when he was replaced by John Kane; as Chief Executive Officer ("CEO") from May 1995 until his resignation on August 22, 2000; and as Chairman of the Board of Directors from June 1999 until his resignation on August 22, 2000. As of May 9, 2000, Defendant Bryan was the beneficial owner of 2,235,678 shares of ICG common stock. By virtue of his positions as President, Chairman and CEO, and the size of his holdings of ICG common stock, Bryan was a controlling person of the Company and exercised his power and influence to cause ICG to engage in the wrongful conduct complained of herein. Bryan was responsible for ICG's communications to securities analysts and investors during the Class Period and reviewed and authorized the release of ICG's publicly reported quarterly financial statements for the first and second quarters of 2000, and the Company's reports on Form 10-Q filed with the SEC for each of these quarters. Furthermore, Bryan signed the Company's 1999 Form 10-K, which the Company filed with the SEC on or about March 31, 2000, and was responsible for

the Company's communications to the financial community on December 9, 1999 and throughout the remainder of the Class Period.

33. Defendant William S. Beans, Jr. joined the Company in July 1999 as Executive Vice President of Network Services and served as the Company's President and COO from January 1, 2000 until his resignation on December 4, 2000. By virtue of his positions as Executive Vice President and COO, Beans was a controlling person of the Company and exercised his power and influence to cause ICG to engage in the wrongful conduct complained of herein. Beans was also responsible for ICG's communications to securities analysts and investors during the Class Period and also reviewed and authorized the release of ICG's publicly reported annual and quarterly financial statements during the Class Period.

SUBSTANTIVE ALLEGATIONS

34. Lead Plaintiffs' allegations are based on an extensive investigation by Lead Counsel, including but not limited to, interviews with the following former ICG employees:²

² All witnesses whose information appears in bold and italics represent witnesses who have been interviewed for the first time in connection with this Second Consolidated and Amended Complaint.

Title	Witness	Dates Employed at ICG
Senior VP of National Sales	Vince Dibiase	1997-Late 2000
Executive VP of Governmental Affairs	Cindy Schonhaut	2/1996-11/2000
Executive VP of Network Services	Hank Carabelli	1996-12/1999
Chief Technology Officer and Executive VP of Operations	Michael Kallet	1998-10/2004
VP of Business Network Systems	Virginia T. Cash	4/1997-9/1999
Senior VP of Finance and Colorado Controller	John Colgan	1994-2004
Senior VP for National Sales	Lucia Esposito	8/1996-4/2000
VP for Colorado Region	Barrett Zahn	1995-10/1999
Infrastructure Program Manager	James Adkins	3/2000-11/2000
SVP of Marketing/ President of ChoiceCom	Carey Balzer	10/1997-8/1999
VP of Customer Service	Karen Elmont	1993-12/2000
Director of Customer Service	Nancy Hoag	10/1996-12/1999
Infrastructure Program Manager	Staci Ann Gardetto	2/2000-2003
Field/Infrastructure Program Manager	Scott Mohrbacher	9/1999-12/2000
Senior Manager, National Process Staff	Bruce Tully	3/1997-10/1999
Senior Account Executive	Peter S. Lin	1999-2001
Technical Consultant and later a Supervisor of the Technical Consultants	Dan Rosales	9/1998-9/2000
Technical Consultant	James Negrete	8/1999-9/2000
Technical Consultant	Ernie Navarette	10/1996-9/2000
Technical Consultant	Tracy Shifflet	5/1997-10/2000
Technical Consultant	Bob Cornish	1997-12/1999
Data Technician	William S. Bean	8/1998-11/2001

THE LINE COUNT FRAUD

A. ICG Attempts to Become The Nation's Leading Provider of Telecommunications Services to Internet Service Providers

1. ICG's Historical Local Telephone Business

35. Following the passage of the Federal Telecommunications Act of 1996 ("Telecommunications Act"), ICG entered the local telephone services market. Taking advantage of the deregulation of the telecommunications industry, ICG planned to compete with incumbent local exchange carriers ("ILECs"), long distance carriers and other communications service providers in providing a full range of communications services. At the time, ICG's primary business was selling telecommunication lines for the transmission of voice data to local phone service providers.

36. While Wall Street typically values businesses on the basis of reported revenues and earnings, the markets focused their valuations of CLECs by looking to the number of revenue-producing telecommunications lines that a CLEC reportedly sold in any given period and the number of lines that the CLEC would likely sell in future periods.

2. ICG Decides to Pursue the Internet Opportunity

37. The late-1990's brought a changed economic environment and seemed to open a new business opportunity for ICG. The Internet was becoming available on a mass scale and Wall Street took notice, rewarding companies that successfully entered this new market with rapidly rising stock prices and generous access to the world's capital markets.

38. In an attempt to capitalize on Wall Street's favorable perception of the emerging Internet industry and led by Defendant Bryan during this period, ICG made a significant shift in its business strategy. ICG decided to transform itself from a traditional telephone services provider, relying on limited-capacity voice data lines, into an Internet network services provider, relying on high-speed, broad capacity, data transmission lines that could be used to transport voice, video and all of the other data comprising the growing market for Internet-based traffic.

39. As it did with traditional CLECs, Wall Street valued Internet-based network service providers based on the number of revenue producing lines they owned. Critically, while a traditional CLEC typically could not report block-buster line count growth, data-transmission lines for the Internet were often ordered and installed by the tens or hundreds of thousands by the relatively concentrated number of major ISPs in the marketplace. Accordingly, the potential to generate massive line counts, which in turn would result in higher market valuations, was greater for a CLEC in the ISP business than it could ever be for one focusing solely on the local phone business.

40. In late-January 1998, ICG acquired NETCOM On-Line Communications Services, Inc. ("NETCOM"), a provider of Internet connectivity and website hosting services. As part of the NETCOM acquisition, ICG obtained NETCOM's "internet backbone" assets, including Points of Presence ("POPs") serving more than 700 U.S. cities.

41. ICG's new business model was substantially more complicated than its previous model, which consisted of simply selling lines for local phone services. ICG set out to establish and provide network system integration services whereby ICG would maintain an independent network for ISPs so that when an ISP's customer would access the Internet via the ISP's platform, the customer's data transmissions would actually take place over an ICG data line linked to ICG's network. In other words, ISPs purchased access to and use of ICG's network by paying for a number of lines that connected the ISP's customers to the ICG network. This was referred to as remote access service or RAS. By February 1999, ICG began to offer its RAS to ISPs and other telecommunications providers through its National data network.

42. According to Mike Kallet, ICG's former Executive Vice President of Operations and Chief Technology Officer, by providing access to ICG's own switch location, RAS eliminated the need for an ISP to deploy modems physically at each of its Points of Presence. Kallet explained that the RAS service reduced an ISP's capital expenditures by transferring a substantial portion of the ISP's network management responsibilities to ICG. The RAS service meant that the ISPs became dependent on ICG's network hardware and network management expertise. Kallet explained that these services were very appealing to ISPs, who generally did not want to deal with the burdens that come with network ownership, including building and servicing a network. Instead, ICG's RAS allowed the ISPs

to focus their energies on the sales and marketing of their services to the end-users.

3. Defendant Bryan and Beans Knew That ICG Would Need Significant Outside Capital In Order to Successfully Build a National Data Network

43. Between 1996 and 1999, ICG developed its networks at a torrid pace, with capital expenditures growing from \$162 million in 1996, to \$261 million in 1997, \$356 million in 1998, and \$735 million in 1999.

44. By the end of 1999, ICG had leased 18,000 miles of fiber optic lines and constructed 4,596 miles of its own network. However, much of this expansion was financed with debt and long-term lease obligations. The Company's long-term debt ballooned from \$400 million in 1995 to almost \$2 billion by the end of 1999.

45. By the end of 1999, Bryan and Beans realized that ICG faced a serious crisis because its revenue could not keep pace with the cost of building the network. Although revenue reached \$479 million in 1999, the Company's operating loss rose to \$206 million and its pre-tax loss from continuing operations hit \$404.5 million. Between 1995 and the end of 1999, ICG racked up cumulative pre-tax losses of \$1.4 billion.

46. In light of its massive debt and ever-growing expenditures, Bryan and Beans knew that in order to execute their plan to build a national data network, they would have to obtain significant financing. They understood that in order to obtain such financing they would first have to prove to Wall Street and the investing community that the Company's new business model was succeeding.

4. Immediately Upon His Arrival at ICG in July 1999, Defendant Beans, With the Active Participation of Defendant Bryan, Assumes Direct Oversight--via Weekly and Monthly "Executive Meetings--Over ICG's Reported Line Counts

47. The importance of ICG's line count to Wall Street's valuations of ICG was not lost on Bryan and Beans. Indeed, as soon as Beans arrived at ICG in early July of 1999, he completely centered ICG's business efforts on meeting or exceeding Wall Street's line count expectations. As described below, he and Bryan remained intimately aware of and involved in monitoring this critical valuation metric, and when outside circumstances, including ICG's failing network (which is further described below), threatened ICG's ability to continue reporting rapid line count growth, Bryan and Beans pursued an intentional strategy of artificially inflating the Company's publicly reported line count.

48. The first step in Bryan's and Beans' plan to rapidly increase ICG's revenue-producing lines was to re-focus ICG's business away from selling traditional voice lines to local telephone providers to almost exclusively selling network services and data lines to ISPs. According to Lucia Esposito, ICG's Senior Vice President for National Sales at the time, when Beans joined the Company he made it clear that he was going to emphasize sales to ISPs over sales to commercial customers because the ability to generate line count was much better on the ISP side. In fact, according to Esposito, sales of network access lines to ISPs soon accounted for almost 80% of the Company's line count. Barry Zahn, the former Vice President for the Colorado Region, confirmed that line count became Bryan's and Beans' primary concern in the running of ICG.

49. Shortly after his arrival at ICG, Beans began holding weekly “executive meetings” to directly monitor ICG’s satisfaction of Wall Street’s line count expectations. These meetings took place every Wednesday afternoon in a 6th floor conference room of ICG’s corporate headquarters in Denver, Colorado. According to Vincent Dibiase, ICG’s Senior Vice President of National Sales, himself a regular participant in Beans’ weekly meetings, the other regular attendees included Beans; Harry Herbst, ICG’s Chief Financial Officer; Kim Gordon, ICG’s Senior Vice President of Retail Marketing; Hank Carabelli, ICG’s Executive Vice President of Network Services; ICG’s Vice Presidents of Provisioning, Terry Mobley and Michael Harry; and Michael Kallet, after he became ICG’s Executive Vice President of Operations and Chief Technology Officer.

50. In addition to these weekly meetings, Bryan convened larger monthly meetings that lasted for two hours, with at least the first forty-five minutes devoted exclusively to the Company’s line count. According to Dibiase, Beans also led these monthly executive team meetings, with Bryan actively participating in the decision-making process and signing off on all line count reporting practices, certain of which are detailed below.

51. According to Barry Zahn, former Vice President for the Colorado region, Beans was also especially focused on ICG’s use of a new product from Lucent Technologies, the Lucent 5ESS Switch. ICG’s 10-K for fiscal year 1998 explained the Company’s plan to use this Lucent switch as follows “The Company

is currently retrofitting all of its Lucent-5ESS switches with the new Lucent product that allows for RAS functionality. This service eliminates the need for ISPs to separately purchase modems and shifts the network management responsibilities to the Company. The Company plans to be the first to market RAS using Lucent's modem technology and expects the service will be available to customers in the second quarter of 1999." As described below, the malfunctioning Lucent equipment was a significant source of ICG's network failures and customer complaints.

B. ICG Touts Its New ISP Products And Services To Wall Street

52. By the Third Quarter of 1999, ICG was aggressively touting the success of its new ISP-centric business model to Wall Street. According to a Company press release issued on September 29, 1999, ICG had "positioned itself to take advantage of explosive Internet growth, increasing its ISP business by an annual overage of more than 200 percent since it began servicing the ISP market in 1997." In that same press release, the Company announced that it had more than "400 ISP customers, most of which take service at one of ICG's 30 co-location sites" and that it was providing "dial up Internet access for 10 percent of the nation's Internet traffic."

53. ICG's Form 10-Q for the third quarter of 1999, ended September 30, 1999 ("Third Quarter 1999 10-Q"), which the Company filed with the SEC on or about November 15, 1999, highlighted this aspect of its new enhanced data service to ISPs. ICG explained that its "modemless remote access service" ("RAS"

or “IRAS”) also known as managed modem service, “allow[ed] the Company to provide modem access at its own switch location, thereby eliminating the need for ISP’s to deploy modems physically at each of their POPs.” According to the Company’s Third Quarter 1999 10-Q, the benefit of their new managed modem service was that it would shift the responsibility of managing the network away from the ISPs to ICG by connecting the modem bank to the Company’s local switch. The 10-Q explained that the Company’s new network allows the ISPs to use ICG’s national data network rather than having to build and maintain their own. ICG would accomplish this by providing “radius routing and proxy services at the modem bank connected to the Company’s local switch, which services are the authentication services necessary to validate and accurately route incoming call traffic to the ISP.”

54. Most critically, the Third Quarter 1999 10-Q highlighted to Wall Street that ICG’s new network service was already resulting in an unprecedented increase in ICG’s revenue-producing line counts and would continue to do so in the coming quarters. For example, ICG’s Third Quarter 1999 10-Q reported the following:

- “In June 1999, the Company entered into a five year agreement with Qwest Communications Corporation (“Qwest”), whereby Qwest has agreed to purchase 100,000 RAS ports from Company. The Company has installed 60,000 of Qwest’s RAS ports as of September 30, 1999, with the remaining 40,000 RAS ports to be installed prior to June 29, 2000.”
- “In August 1999, the Company “signed a long-term contract with a national ISP to provide 100,000 RAS ports to the ISP for a minimum five-year term.”

- “That as of September 30, 1999, the Company had 100,000 of the RAS ports installed, including 83,000 ports previously providing local access services which were upgraded to accommodate RAS. Throughout the term of the agreement, the Company will install up to 100,000 RAS ports for NetZero. Service Delivery is expected to begin in early 2000.”
- “In September 1999, the Company signed a three-year agreement with NetZero, Inc., a leading provider of free Internet access (“NetZero”), to deliver Internet RAS. Throughout the term of the agreement, the Company will install up to 100,000 RAS ports for NetZero. Service delivery is expected to begin in early 2000.”
- “...the Company signed an agreement in October 1999 with Microsoft Network, L.L.C. (“MSN”) to provide Internet RAS to MSN for a three-year period. Under this agreement, MSN will purchase the use of a minimum of 150,000 RAS ports. “The Company expects to install approximately 100,000 of these RAS ports by April 30, 2000 and the remaining 50,000 by October 2000.”

C. Based On The Company’s Description of its New Network and ICG’s Reported Line Sales to ISPs, Wall Street Raises Its Valuations of ICG and ICG Raises Over \$1 Billion in Financing

55. By the end of 1999, ICG’s emphasis had almost completely shifted from selling voice data transmission lines to providing network capacity and selling data transmission lines to ISPs. As evidenced by analyst reports issued in the fourth quarter of 1999, Wall Street valued ICG based on these reported line counts and the potential for future lines as much as, if not more than, its reported actual revenues. As a result, Wall Street marveled at the line count generating potential of ICG’s new ISP products and services. Wall Street’s bullish views were largely based on ICG’s own representations that its new ISP business would be a line generating machine. In valuing ICG’s stock, Wall Street relied heavily on ICG’s ability to build and maintain the networks for the ISPs. Indeed, because the vast majority of its line count came from data transmission lines sold to ISPs, which

would only produce revenue if the network worked properly, the lines ICG were reporting to Wall Street were meaningless if its network failed to work.

56. For example, on October 16, 1999, Frank Murphy of First Union Securities rated ICG as a “Strong Buy” specifically focusing on the Company’s RAS and IRAS as the “jewels in ICG’s arsenal of products and services.” First Union’s report highlighted that the Company’s new business of “providing wholesale Internet-access service to the ISP community” was now the “major focus” of the Company.

57. As evidenced by the First Union report, Wall Street was expecting ICG’s strategic shift, and new PRI and RAS/IRAS products, to generate significant new lines and line-based revenues. Specifically, the First Union report explained that “[a]s the ISP marketplace continues to rapidly grow, ISPs are experiencing a greater need for networking services since most of them do not own their own networks. ISPs generally do not possess the scale to make network ownership economical and prefer to concentrate on their core strengths (such as sales and marketing) while outsourcing their networking requirements.” The First Union analyst believed that ICG’s new business model addressed the ISP community’s need for an outside network, with their PRI and RAS/IRAS products and services “leading the way.”

58. The First Union analyst’s “Strong Buy” recommendation was based on the belief, “[t]hat as a result of its solid commercial line and ISP port growth, [he] expect[ed] ICG to end 1999 with nearly 700K lines/ports installed, with the

expectations that ICG will install 712,500 lines/ports in 2000 bringing its total approximately 1.4 million total lines/ports in service at year-end 2000.” The analyst further estimated that “ICG will end 2000 with...17.4% market share on the port side, versus 9.7% currently.”

59. Having successfully touted its new strategy and promised results, beginning on December 9, 1999 (the first day of the Class Period), Defendants Bryan and Beans repeatedly and falsely exaggerated to the market the extent to which ICG was actually reaping the benefit of its strategy by actually booking thousands of new revenue producing lines sold to ISPs. Specifically, on December 9, 1999, at 9:00 AM MST, defendants Bryan and Beans hosted a conference call for financial analysts. During that conference call they stated that ICG's fourth quarter 1999 performance would meet or exceed the earnings estimates previously published by the financial analyst community, and was on track to report break-even EBITDA for full-year 1999. In addition, Bryan and Beans said that ICG would install 115,000 or more lines and ports in the fourth quarter, and emphasized ICG's strong sales of 400,000 to 450,000 of RAS/IRAS ports to major ISP customers, with another 200,000 ports to be announced shortly. Bryan and Beans further informed the investing public that the approximately 770,000 ports that the Company had contracts for at that time were going to provide an estimated \$300 million in fixed payments to ICG (not including the reciprocal compensation that would be generated by the ports).

60. As a result of ICG's shift from providing traditional local telephone services to providing network capacity for ISPs, which ICG and Defendants Bryan and Beans falsely stated was already succeeding, ICG's stock price rose from \$16.75 on December 9, 1999 to as high as \$39.00 by March 27, 2000.

61. As a result of these and other analyst's reports, and ICG's reported successes with its new business, ICG was also able to obtain the financing it needed to survive. In February 2000, ICG announced that it had arranged to sell \$750 million of convertible preferred stock to three investors: affiliates of Liberty Media; Hicks, Muse, Tate & Furst; and Gleacher Capital Partners. Liberty was the largest investor, providing \$500 million to ICG, followed by Hicks Muse at \$230 million, and then Gleacher Partners at \$20 million. The transaction gave Liberty Media the equivalent of 24.5 million shares of ICG's stock, or 33.5% of the total shares outstanding and Hicks Muse the equivalent of 11.28 million shares, or 18.8% of the total shares outstanding. ICG also received an additional \$430 million in vendor financing, consisting of \$180 million from Cisco on January 27, 2000, and \$250 million from Lucent on February 29, 2000. All told, ICG was able to raise over \$1 billion in outside capital. The magnitude of these investments and the caliber of the investors gave ICG credibility on Wall Street, further contributing to the stock price's rise to a Class Period high of \$39.00 a share in the first quarter of 2000.

D. ICG Failed to Disclose the Ongoing Network Defects and Customer Complaints that Would Inform the Market that ICG's Reported Line Count Growth Was Not Sustainable

62. ICG's ability to continue meeting Wall Street's ever-increasing line count expectations hinged on the Company's ability to continue expanding the number of revenue producing lines it sold to ISPs and other third parties. In turn, ICG's ability to sell its lines depended on its ability to properly build, install, and maintain a network of switches, routers, and lines to support its much-touted managed modem services.

63. As Bryan and Beans knew, the hundreds of thousands of lines ICG sold to its customers and reported to Wall Street were worthless to the ISPs if the Company's network did not work properly. Moreover, if ICG experienced sustained technical problems with ICG's network, its customers would cancel their contracts and the market would recognize that ICG could not possibly continue its level of growth in the ISP industry.

64. Although ICG convinced investors and ISP customers alike that ICG could provide a reliable technologically-advanced network, the reality was quite different. As described below, ICG was wholly unequipped to provide the services it promised its ISP customers and touted to Wall Street. Beans and Bryan expanded ICG's network so quickly that major service problems resulted. Rather than admit that ICG's Internet strategy was facing troubles, Bryan and Beans chose to continue touting to Wall Street ICG's reported (and falsely inflated) line count growth.

1. Problems With The Cisco Router

65. According to Jim Adkins, a former ICG Infrastructure Program Manager, in the summer of 1999, the Cisco series 5800 and 6700 routers that ICG purchased for integration with the Company's RAS and IRAS circuits and software had a "glitch" that caused the communication between the routers and switches to completely shut-down. As a result, ICG's entire network would crash at 2:00 a.m. every morning. This caused an onslaught of complaints from the customers who had purchased lines from ICG but were not receiving a reliable network on which those lines could be used.

66. According to William S. Bean, a former ICG data technician, the problem arose from modem-based calls, or public switch telephone networks ("PSTN"), which were considered voice calls until they hit an ICG RAS or IRAS router. The function of the Cisco routers was to convert the call to a data call. As the voice calls came into the RAS or IRAS router and were converted to data, the calls would have to go through an authorization process through which passwords would be verified. The call was then supposed to be sent to an authorization server, but because the RAS router used by ICG did not have a sufficient bandwidth, many of the calls never made it to the authorization server or back to the ISP once they were verified. ICG's RAS router would then incur a protocol violation because the call never came back from the authorization server, causing the voice side to terminate the call and the data side to remain open while waiting for the call to return.

67. According to Adkins, as early as February 1999, the Company had ordered staff at the ICG network operations center (“NOC”) to attend on a daily basis to the problem-riddled software and associated ICG systems failure. NOC Vice President James O’Brien (“O’Brien”) was charged with overseeing the day-to-day operations of the NOC and for attempting to resolve the “glitches” with the Cisco software.

68. According to Adkins, ICG made no progress in fixing these problems in 1999. The continuing problems with the Cisco series 5800 and 6700 routers caused ICG to begin withholding payments to Cisco for the IRAS software in January 2000. The Cisco router and resulting network failure persisted throughout the Class Period, lasting for approximately 20 consecutive months (February 1999 through October 2000). The only improvement ICG was able to make with regard to the ongoing systems failure was in the amount of time required to get the system up and running again. When the IRAS system was initially installed, it took ICG’s NOC technicians the entire night to bring the network back on-line. By early October 2000, the NOC technicians had reduced the ICG network down time to approximately two hours, bringing the system back on-line by 4:00 a.m.

2. Problems with the Lucent Switch

69. Around the same time ICG was having problems with the Cisco routers, it was also having serious issues with its Lucent 5ESS switches, which were the key component to the Company’s new network and its ability to sell lines

to the ISPs. According to Barry Zahn, a former Vice President for the Colorado Region, the Lucent 5ESS switches, at \$7 million per switch, were supposed to be the “Cadillac of switches.” However, according to Zahn, ICG’s plan of combining the 5ESS and its modem banks, a process which Beans himself oversaw, did not work properly.

70. According to Adkins, the Lucent 5ESS data switches could not handle the traffic assigned to them because they were intended to be used for voice data transmission and not ISP data lines, which use significantly greater quantities of switch capacity than standard telephone call traffic lines. According to Zahn, the combination of the Lucent switches with ICG’s modems was never field tested prior to ICG’s rolling the product out for use by its ISP customers. Zahn explained that these the problems continued into late 1999 and beyond.

71. Zahn, the former Vice President of Colorado Service, confirmed that Defendant Beans was fully aware of the problems plaguing ICG’s network. According to him, when Beans learned, in early fourth quarter 1999, that ICG could not get the Lucent 5ESS switch to interface with the managed modem, he “screamed at engineers to get it fixed.” Zahn further reported that even though the engineers informed him that the Lucent switches could not be fixed, Beans ordered that ICG use the product for its ISP customers in late 1999 or early 2000 so the Company could exploit the burgeoning ISP market.

72. In late 1999, ICG agreed to beta test Lucent’s 7R/E data switch, which was specifically designed to handle both standard lines as well as the larger

capacity requirements of data lines. ICG quickly found that these switches, like the Lucent 5ESS switch, simply did not work.

73. According to Adkins, ICG then turned to the Cisco Summa 4 optical switch, which, like the Lucent 7R/E switch, was designed to handle both standard lines and the larger capacity requirements of data lines. Like the Lucent 7R/E switch, the Cisco Summa 4 optical switch did not work.

74. As a result of ICG's on-going network failures, its customers registered a great number of complaints with the PUC regarding ICG's service in 1999. The following are samples of the numerous complaints received by the PUC:

- a. On June 15, 1999, John Sheflin, Customer Engineer for Verio Colorado, wrote the PUC to complain about ICG's service. In his letter, Mr. Sheflin provided a list of orders that are not getting installed by ICG. Verio is an ISP in Denver that relies heavily on the completion of ICG circuits for revenue. Please assist us on the completion or reasons why they are not getting installed;
- b. On August 26, 1999, Chris Magnuson of Peak to Peak Internet, wrote to the PUC and attached a statement from ICG in which ICG admitted to Mr. Magnuson that it could not fill his order because ICG had no capacity, and that the Company had no plans to get capacity any time soon;
- c. On August 31, 1999, Chris Magnuson wrote to D. Knox of the Denver Post and carbon copied the PUC. In his letter, Mr. Magnuson complained that "In January of this year, and for all months since then, all our customers in and around the Longmont areas had trouble placing calls to our ICG-owned facilities. . . . ICG and companies like them sell facilities that they can't make work, they don't help their customers make them work, and they somehow still expect to be paid for supplying products that do not conform to modern telecom standards issued by the standards body";

- d. On September 21, 1999, Jenny L. Gentry, Vice President of Finance and Administration for Colorado Public Radio, wrote to the PUC to complain of a “major unresolved billing problem with ICG Communications. . . .”; and
- e. On October 5, 1999, Mitch Dailey called the PUC because he was “upset with delays between ICG and [U.S. West] in getting his PRI circuit back up. . . . This circuit went down yesterday at 8 a.m. and ICG/USW was finally able to resolve it last night at 8 p.m. By 10 p.m. it had gone down again and remains down.”
- f. On October 21, 1999, Warren Smith, principal for Storage Area Networks, Inc., wrote to ICG to “complain that ICG has consistently provided poor customer service to my company. . . . My company has endured a series of lengthy delays with service orders, which tested our patience.”

75. As Beans knew, and Bryan knew or should have know, if ICG publicly disclosed that its network was experiencing ongoing technical failures, Wall Street would correctly recognize that ISPs would slow down or cease purchasing lines from ICG and the market would lower its valuations of ICG stock accordingly. However, at no time prior to the end of the Class Period did Defendants Bryan or Beans disclose to investors that ICG’s network was suffering critical service failures. Instead, they continued to represent that ICG’s network was functioning well and that ICG’s publicly reported line count growth could be expected to continue.

E. Defendants Bryan and Beans Knew That Their Focus on Meeting Wall Street’s Line Count Estimates Came at the Expense of ICG’s Network and Customer Service

76. As shown below, Defendants Bryan and Beans were specifically informed of the ongoing network problems, which, of course, put ICG’s core

business at risk. Instead of disclosing the problems with the network and explaining the steps being taken to resolve the issue, however, Defendants Beans and Bryan diverted ICG resources to selling and recording lines to meet Wall Street's expectations. Specifically, the members of ICG's "Service Delivery Team," including hundreds of "Technical Consultants," were ordered to focus their energies on selling more lines to ISPs rather than providing support or customer service to existing customers. As explained in detail below, both Bryan and Beans were aware even before the Class Period that ICG's focus on pushing line counts was creating a customer crisis that would eventually cause the Company's fortunes to flounder.

77. According to Tracy Shifflet, a former ICG Technical Consultant the Colorado region, on August 27, 1999, ICG hosted an all-day focus group at the Wyndham Albuquerque Hotel in Albuquerque, New Mexico, to afford employees from various regions an opportunity to raise questions and air concerns with ICG's senior management, including Defendant Beans. According to Shifflet, Keith Abraben ("Abraben"), ICG's Senior Director of Employee Relations, presided over the meeting, which was structured as a "question-and-answer" session. Shifflet further stated that a court reporter transcribed everything that was said at the focus group and that the transcript was bound into a book called "Relationships by Objectives" ("RBO"). The Court reporter was specifically instructed to underline every question raised at the RBO meeting so that the questions could be extracted

and put into a single document that would be provided to ICG's senior management, including Defendant Beans.

78. According to Shifflet, Abraben specifically told the group assembled at the August 27, 1999 focus group that the RBO would be distributed to ICG's senior management, including Defendant Beans. ***Indeed, on page 30 of the RBO, Abraben specifically states that the issues raised at the focus group were intended to "land on Beans' desk."*** According to Shifflet and as confirmed in the RBO, Abraben further assured employees that: "You're going to be surprised how quickly this information is disseminated upstairs. It may take you, in normal channels, six weeks for it to get upstairs; it's not going to take probably but six minutes for it to get upstairs." (RBO, at p.169). To that end, Abraben further stated: "I'll tell you, as I said earlier, at the outset, when these questions get formulated and sent out to the owners of them, wait; this is going to be like the shot heard round the world." (RBO, at p.171). Although Bryan is not specifically named in the RBO, Bryan apparently received the report because Abraben also told the ICG employees in attendance that ***"[t]he good part about this is that his boss is going to get this, and his boss' boss is going to get this."*** (RBO, at p.172).

79. A major topic of discussion at the August 27, 1999 focus group was ICG's failure to provide adequate service to its customers because the Company was devoting all of its Technical Consultants and Service Delivery Team members to the selling of lines. The comments and complaints lodged by ICG's staff made

clear their view that ICG's senior management abandoned customers after a line sale was made.

80. For example, Mike Tripp, then a member of ICG's Service Delivery Team in Colorado, asked ICG's senior management the following question: "Is there anything being done to – I guess, basically, what is being done to try to shorten the standard interval for an installation? For a lot of customers, 45 to 60 days seems like a long time for it to be delivered." (RBO, at 126). Along the same lines, Peter Roberts, then a Technical Consultant in ICG's Nashville region, stated that there was "[n]o way we can handle this. I can't tell you how often customers call, when it's two days. What are you going to tell a customer, 'Six weeks, we'll get a couple of lines in?' If you want to tell them the truth, that [is] about what it is. Not that you – I can't just tell a customer 'Well, I'll get you your two lines in six weeks.' I say '10 days' and push it through: Stand on it, jump up and down, try to get it, if they need it. Because if they're having busy signals or something like that, they need to add some more lines. But as far as the customer calling – not just me, they're calling the CAMs; they're calling everybody. And it really hurts the people around you. Really hurts their morale because they care about their customers, and Bell can get it done in three to five days. We can get it done in three to five weeks." (RBO, at p. 143).

81. Mr. Diller, an ICG Sales Engineer, confirmed that "...the customer is furious. Try to hide a lot from the customer right now. Have to. You feel guilty, if you tell them but we're in a situation where, if you tell them the truth, you lose

business. We're putting our names and faces on the line. We need somebody [in senior management] who will listen to us, number one, and actually do what we're requesting, to expedite it." (RBO, at p. 145).

82. The Technical Consultants specifically expressed their belief that the customer neglect was the result of Defendant Beans' single-minded obsession with meeting the line count expectations. To that end, Don Olenik, then a member of the Sales Team in ICG's Akron, Ohio region asked a poignant question: "When will Bill Beans initiate customer service?" (RBO, at p. 168).

83. The group specifically questioned ICG's and Beans' focus on increasing the reported line count at whatever cost, which caused ICG to neglect customers who had already purchased ICG lines and needed service. Shawn Shelton, then a Technical Consultant from ICG's Cincinnati, Ohio division stated that after ICG was done booking orders that were not going to be installed in the near future the "...net effect is, you did a quarter of what the paper shows." (RBO, at p. 100). Phil Goar, then an Installation Coordinator in Colorado explained that "...everything you hear about is line count, line connect, but how many disconnects do you hear about," referencing ICG's failure to remove lines from its line count even after customers cancelled the corresponding service (a practice that is further discussed at paragraphs 108-113 below) (RBO, at p. 101).

84. What the attendees of the RBO meeting did not realize, however, was that the problems at ICG were only beginning at that time. More importantly, the facts that the members of ICG's Service Delivery Team, including its Technical

Consultants, engineers, and installation coordinators, highlighted for the benefit of ICG's senior management, including Defendants Bryan and Beans, were not disclosed to Wall Street and the investing public until almost a year and half later—namely, that Beans' and Bryan's emphasis on booking lines at all costs would have a disastrous effect on ICG.

F. Bryan and Beans Implement A Fraudulent Policy Of Meeting Wall Street's Line Count Expectations At All Costs

85. As noted above in ¶¶ 47 to 51, as soon as Beans joined ICG in July 1999 he shifted the Company's focus to pushing line counts, and he remained directly involved in the process through the "executive meetings" that he implemented. The purpose of these meetings was initially to keep top executives, including Beans and Bryan, apprised of the status of ICG's line counts. According to Zahn, by the fourth quarter of 1999, the technical problems with ICG's network threatened the lines that were already sold to the ISPs and threatened ICG's ability to legitimately meet Wall Street's expectations. As a result, these weekly executive meetings became focused almost exclusively on ways for the Company to artificially inflate its line count to meet or exceed Wall Street's line count expectations.

86. According to Lucia Esposito, ICG's former Senior Vice President for National Sales, Beans always showed up at the meetings with a leather binder containing a detailed breakdown of line counts by region and by customer. She further recalled that Beans spent much of the meeting flipping through the binder

and discussing where lines were installed, where the work was still incomplete and when they anticipated that the incomplete work would be completed.

87. Nancy Hoag, ICG's former Director of Customer Service for the Colorado region, was the ICG Director responsible for preparing the line count spreadsheets that were used by Beans in these executive meetings. According to Hoag, the "line-count spreadsheets" would clearly delineate the exact status of each of ICG's lines in various columns, including columns for all lines that were sold and installed, lines that were sold but not actually installed, and when they anticipated the uninstalled lines would be installed.

88. Hoag explained that ICG traditionally counted lines only when they were sold and already installed or scheduled to be installed on a set date within a short period of time. Hoag explained that this practice drastically changed after Beans arrived. Hoag stated that when she would receive the Company's official line count generated from Beans' "executive meetings," it was clear that Beans often counted all of the columns, many of which included lines that were not going to be installed for months and some which had no planned installation date at all. According to Hoag, whenever ICG needed a change in line count methodology to meet a particular quarter's line count projections, Beans would simply take every column of her reports and add them together.

89. Revenue related to these lines was similarly inflated. According to the Company's 1998 Form 10K, which was incorporated by reference in the

Company's Third Quarter 1999 10-Q, the Company recognized revenue for the installation of lines and on lines in service according to the following policy:

(k) Revenue Recognition

The Company recognizes Telecom Services and Satellite Services revenue as services are provided and charges direct selling expenses to operations as incurred. **Revenue from Network Services contracts for the design and installation of communications systems and networks, which are generally short-term in duration, is recognized using the percentage of completion method of accounting.** Maintenance revenue is recognized as services are provided. Uncollectible trade receivables are accounted for using the allowance method.

Revenue which has been earned under the percentage of completion method, but has not been billed to the customer, is included in revenue earned, but unbilled in the consolidated financial statements. Deferred revenue includes monthly advance billings to customers for certain services provided by the Company's Telecom Services and Satellite Services, as well as Network Services revenue which has been billed to the customer in compliance with contract terms, but not yet earned under the percentage of completion method.

90. Thus, ICG claimed that it would only recognize lines that were installed and revenue producing. As shown by Ms. Shifflet, Ms. Hoag, and the numerous other witnesses whose statements are summarized below, that was simply untrue. Further, according to Dan Rosales, a former Technical Consultant and Jim Adkins, during the third quarter of 1999, the defendants reported revenue on substantially more lines than had actually been installed, violating Company policy and artificially inflating revenue. The Company's revenue recognition policy allowed revenue to be recognized on lines as they were installed and as services on those lines allegedly were provided to customers. Because many of the

Company's reported lines had not yet been installed and in fact did not exist, defendants violated Company policy by reporting revenue on those lines in the third quarter of 1999, and artificially inflated their revenues.

91. According to Dibiase, the former Senior Vice President of ICG's National Sales, meeting Wall Street's line count expectation was a major topic of discussion at every executive meeting held, ***especially those held during the fourth quarter of 1999 and the first quarter of 2000.*** According to DiBiase, once it was clear that ICG had no chance of making its line count and revenue estimates during that time period, the discussion invariably turned to meeting analysts' expectations by any means necessary.

92. Dibiase recalled that both Defendants Bryan and Beans routinely instructed him, in words or substance, to "do whatever you have to do to make our line count." In one particularly telling exchange during an executive team meeting at the end of Q4 1999, Dibiase the former Senior Vice President of National Sales even recalled Beans saying "I don't give a (expletive) if you've got to give them away, just make the (expletive) line count." As if the point had not been made, Beans routinely telephoned Dibiase, the former Senior Vice President of National Sales, after the executive meetings to reiterate his demand that Dibiase do whatever it took to meet the market's expectations for ICG's reported line counts.

93. Dibiase and ICG's senior executives were not the only people who were instructed by Beans to create lines. Indeed, Dan Rosales, then a Technical Consultant at ICG, stated that only weeks before the close of the fourth quarter of

1999, Beans confronted him and the other Technical Consultants, and stated that their jobs were in jeopardy because the Company had fallen behind the expected line counts. Beans specifically stated to the technical consultants that **“You will create lines. You have three days.”** The Technical Consultants complained to one another that lines could not simply be created, but instead first required a sale. The Technical Consultants were also concerned because there were typically very few orders, or sales, during the month of December. Despite their initial complaints, the Technical Consultants “created lines.” The Company systematically replaced any technical consultants who were unwilling to comply with Beans’ order.

94. Karen Elmont, a former Vice President of Customer Service, had a similar recollection, stating that that Defendant Beans routinely put “ugly pressure” on her to make her line count and told her to “go figure it out” whenever she questioned how expectations could be met when the lines simply did not exist. Elmont stated that Beans consistently told her, as well as other senior executives, that ICG would never miss their line count. Pursuant to Beans’ explicit orders never to miss its line count target, according to Elmont, senior management resorted to using any means at their disposal to create lines. Elmont explained that Beans was aware of and in many instances expressly approved of these methods for creating lines. She further explained that in light of his engineering background there was no question that he understood that these methods were illegitimate.

95. Elmont, who stayed at ICG until December 2000, stated that by early 2000, it became increasingly difficult to sell new lines, in part because CLECs like ICG had saturated the market, and also because ICG was having so many problems with the network that its current ISP customers were refusing to buy any more lines until the service issues were addressed and resolved. Moreover, even if the Company made a sale, she explained, the Company did not have the networking equipment to get the lines installed and working. As a result, Elmont stated that ICG continued to artificially inflate lines through the first and second quarters of 2000.

96. Defendant Bryan was not only aware of the improper practices sanctioned during the monthly “executive meetings,” he also understood that these practices were implemented and resulted in false line counts. Elmont specifically recalled that Bryan consistently congratulated the senior executives on doing great jobs with respect to the very projects where ICG had committed the most egregious line inflations. Under the circumstances, this led her to conclude that Bryan was well aware of all of these fraudulent practices. These same circumstances, especially coupled with the other allegations of his specific knowledge and participation of wrongdoing, support a strong inference that Bryan was, in fact, aware of these improper line counting practices.

1. Beans and Bryan Specifically Devised and Approved Numerous Methods Through Which ICG Inflated Line Counts

97. The official line count that ICG reported to investors was tabulated using the Company’s “DTOTS” database, which, by Company policy, was

supposed to include only those lines that were installed and revenue-producing. According to Dibiase, Elmont, Zahn, Hoag and others, Defendants Bryan and Beans spearheaded the creation of numerous manipulative practices to assure that ICG would meet or exceed Wall Street's line count expectations.

98. According to Dibiase, beginning by no later than December 1999 and continuing until the end of the Class Period, Defendants Bryan and Beans directed the executive team to artificially boost ICG's line counts in the following ways: (1) by selling discounted lines, delaying billing, and even offering free lines; (2) by pushing line count cancellations into future quarters; and (3) by adding various types of non-revenue-producing lines into ICG's DTOTS database.

99. In fact, Lead Plaintiffs extensive investigation has confirmed that that in direct response to the instructions of Bryan and Beans, ICG personnel used various methods that fraudulently inflated ICG's Line Count, including counting the following types of non-revenue-producing lines in ICG's official reported line count: (1) non-billable lines; (2) cancelled lines; (3) internal lines; (4) uninstalled lines; (5) non-existent lines (*i.e.* 169,000 lines being billed to a switch with an 84,000 line maximum capacity); (6) "in" lines; and (7) ISP "free" lines.

100. Dibiase and Elmont both stated that these practices were most prevalent in Q4 1999 and Q1 2000. Jim Adkins confirmed that these practices were also prevalent in the 2Q 2000.

101. By requiring ICG employees to pursue these improper practices, which are further described below, Defendants Bryan and Beans regularly and

deliberately violated ICG's own line counting policy. For example, at the commencement of the Class Period, Defendants represented that ICG's line count at the end of the third quarter of 1999 was 585,000 and that a minimum of an additional 115,000 lines had been and would be installed by the end of the fourth quarter. That was patently false. As the Defendants knew from discussions at the weekly "executive team" meetings, the actual number of lines that could properly be booked as installed revenue producing lines was only a fraction of what ICG was reporting to Wall Street.

102. Indeed, according to Adkins, who audited various ICG switch sites, audit reports and subsequent internal investigations shown to ICG's senior management demonstrated that approximately 75% of the lines entered into the DTOTS database during the Class Period were phony.

103. With Bryan and Beans at the center of ICG's line count inflation, the practice became embedded in ICG's corporate culture. In addition to the numerous former ICG employees who provided specific details explaining how ICG inflated line counts at Bryan's and Beans' direction, virtually every witness confirmed that the fact of line count inflation was well known within the Company, including low level employees who were not directly involved in the process, as well as by members of senior management. In fact, according to Tracy Shifflet, a Technical Consultant in Colorado, the number of ICG's publicly reported lines that were also actually real became "a standing joke" among ICG employees who were forced to comply with Bryan's and Beans' improper instructions.

104. Shifflet explained that on more than one occasion, she and other Technical Consultants approached Douglas Falk, Chairman and CEO of ICG's Satellite Services and President of ICG's Telecom Group, regarding ICG's fabrication of lines. Shifflet stated that these efforts were in vain because the recognition of phony lines was endemic at ICG. She stated that neither Falk nor any of her other supervisors who she informed about these practices ever took any action to stop them.

a. Non-Billable Lines

105. According to Dibiase, during one "brainstorming" session at an executive team meeting led by Beans, during the fourth quarter of 1999, Defendants devised a scheme in which ICG would offer delayed billing or bargain rates to certain large customers if the customers agreed to take lines that they did not need. According to Elmont, Defendants referred to the deals as "Blue Light Specials." Defendants Beans and Bryan specifically approved of the practice and directed Dibiase to execute as per their instructions.

106. According to Dibiase, using this tactic, ICG coaxed both NetZero and UUNet to accept between 6,000-10,000 lines each in the fourth quarter of 1999. Defendants included the lines in ICG's reported line count for the fourth quarter of 1999, despite knowing that installation would not be complete until the first quarter of 2000 and, further, that both companies would reject a substantial portion of the lines prior to installation.

107. Karen Elmont, a former Vice President of Customer Service, confirmed that ICG's official reported line count for the fourth quarter of 1999 also included "phantom" lines sold to customers under delayed billing agreements. Elmont explained that under this particular scheme, ICG would bill the customer for the lines at the end of 1999, "disconnect" them in the first quarter of 2000 without ever having installed them, and credit the customer's account for the one-month charge. According to Elmont, ICG executed one such deal with UUNet in the fourth quarter of 1999. Defendant Bryan gave her every indication that he knew of the practice, congratulating her frequently regarding that deal and on other such deals, such as one with AOL, where it was common knowledge within ICG that line counts were inflated.

b. Cancelled Lines

108. Dibiase explained that premature recognition of lines was only the beginning of the fraudulent practices implemented by Bryan and Beans with respect to the NetZero and UUNet projects. According to him, at very end of the fourth quarter of 1999, UUNet and NetZero determined that they actually did not need the amount of lines they had originally agreed to and informed ICG that they decided to cancel a significant portion of their order. Dibiase met with Beans and Bryan to inform them that ICG had no choice but to remove the approximately 6,000 to 10,000 lines from its official line count, thereby significantly lowering the Company's line count for that quarter.

109. According to Dibiase, Beans instructed him not to remove the lines from the line count database until the first quarter of 2000. Dibiase stated that Beans told him that the Company should act as though it did not realize this was going to happen, essentially to “play dumb.” According to Dibiase, Defendant Beans told him that he wanted to wait to remove the lines in a quarter where it did not affect ICG’s ability to meet Wall Street’s expected line count for the Company.

110. Bruce Tully, a former Senior Manager of ICG’s Process Staff, supported this account. Tully said that ICG’s year-end 1999 line count was inflated by between 30,000 and 50,000 lines in large part because senior management directed staff not to disconnect cancelled lines until the following quarter. “Customers would cancel their orders and we were told not to disconnect them now. We were told to do it next month,” he reported.

111. Peter S. Lin, a former Senior Account Executive, also corroborated this practice, reporting that ICG inflated line counts by selling customers more lines than they could use and then keeping those lines as part of the official reported line count even though the customers cancelled the unnecessary lines.

112. Jim Adkins reported that ICG also “double-booked” revenue on thousands of accounts that had previously been cancelled. Specifically, although ICG was recognizing revenue attributable to the customers that it had switched over to the NETCOM network that it purchased in early 1998, the Company also continued to book monthly revenue from these customers as if they were still using ICG’s original frame relay network. According to him, the majority of the upgraded

customers were located in Oregon, California, Washington, Texas, Ohio, Florida and Oklahoma.

113. According to Adkins, **as late as May 2000**, the Company's Infrastructure Department Program Manager compiled a detailed report describing ICG's "double booking" of accounts previously serviced by the frame relay network. The report was submitted to Richard Fish ("Fish"), the Company's Vice President of Finance, who in turn discussed the report with Defendant Beans. According to Adkins, Fish reported to him that Beans acknowledged the practice, but stated that Defendant Bryan directed it to continue because it was necessary to meet the Company's reported line counts.

c. Internal Lines

114. Dibiase reported that at an executive team meeting in late December 1999, Defendant Beans directed management to include internal lines, which did not produce revenue, in ICG's reported line counts. Defendant Bryan attended the meeting in person and signed off on the practice. Dibiase further stated that as a result of this practice, internal ISP lines installed at the Company's NETCOM subsidiary were added into the DTOTS system in late 1999 or early 2000, thereby including them in the Company's official line count for **either or both of the fourth quarter of 1999 and the first quarter of 2000**. Dibiase specifically confirmed that this was done with Bryan's and Beans' knowledge.

d. Uninstalled Lines

115. According to Staci Ann Gardetto, a former Infrastructure Program Manager, it was a common occurrence **during the first and second quarters of 2000** for senior management to demand that she complete major line installations before the end of a reporting period. She further revealed that the deadlines were so unrealistic that her group failed to meet them nearly half of the time.

116. Invariably, however, after reporting her team's failure to her direct superior, ICG's Vice President of Engineering and Infrastructure, Mike Goedel ("Goedel"), she was told not to worry because Beans had instructed him to add the lines to the DTOTS database, irrespective of whether they had been installed. According to her, Goedel stated that Beans gave the directive because the lines were necessary to show Wall Street that ICG was meeting line count expectations. With respect to at least one large order in **either the first or second quarter of 2000**, she recalled that ICG added between 20,000 and 30,000 uninstalled lines into the DTOTS system, thereby including them in ICG's official reported line count.

117. Bruce Tully, a former Senior Manager of National Process Staff told the same story. According to him, large customers placed orders at the end of 1999 that would not be installed until the following quarter. Nevertheless, Tully was instructed to enter the lines into the DTOTS database, including them in ICG's official reported line count. For example, he reported that senior management told him and Ernie Naverette, a former Technical Consultant, to include lines ordered

by America Online (“AOL”) in late 1999 on the DTOTS system, even though the lines had no chance of being installed until the first quarter of 2000.

118. Tracy Shifflet, Ernie Navarette, and Bob Cornish, all ICG Technical Consultants, and Adkins, corroborated this account, reporting that Defendants routinely included uninstalled lines in the Company’s publicly reported line count. Navarette recalled certain occasions when ICG had contracts that were not closed or the customer had backed out, yet ICG still included those lines within its count. Cornish confirmed that, “some of the lines we put into the [DTOTS] system were not even accepted orders.” He also revealed that when he and his colleagues reported their discomfort with the practice to Doug Falk, Chairman and CEO of ICG’s Satellite Services and President of ICG’s Telecom Group, who reported directly to Defendant Beans, he told them to continue doing it because “everyone’s doing it this way – Worldcom, Global Crossing, Qwest.”

119. According to Virginia Cash, a former Vice President of Colorado Service and Business Network Systems, as pressure to meet Wall Street’s expectations increased in early 2000, and ICG’s ability to legitimately meet those expectations waned, senior management began to include lines that were not even scheduled to be installed until the next quarter or had no planned installation date whatsoever. Cash further reported that she was “absolutely certain” that this practice, among others, significantly inflated ICG’s line counts in the first quarter of 2000.

e. Non-Existent Lines

120. According to Dan Rosales, a former Technical Consultant, **one week before the end of the Company's first quarter of 2000**, Defendant Beans held an "all hands" meeting in the Company's newly centralized provisioning center. At this meeting, Beans specifically stated that ICG was 106,000 lines short of its objective for the quarter. Immediately after this March meeting in the provisioning center, Beans met privately with the Company's Provisioning Director, Terry Mobley ("Mobley") and Vice President of Provisioning, Mike Harry ("Harry") in Harry's office (an open cubicle). Mobley and Harry were part of a larger group of employees that Beans had recruited away from AT&T, known throughout the Company as "Beanie Babies."

121. As Rosales reported it, thirty minutes after Beans' meeting with Mobley and Harry, employees could hear the Company's wholesale group being told to write orders for 25,000 to 50,000 lines, regardless of whether a purchaser or ISP was involved. Specifically, according to him, even though AOL did not place an order during the period, Beans directed Company employees to record 20,000 more lines for AOL. According to Rosales, the wholesale group members were displeased with this directive, but they knew their jobs were in jeopardy if they did not comply. Rosales explained that the false line orders were then counted as complete and added to the Company's official reported line count for this quarter.

122. According to Rosales, **the same scenario unfolded a week before the end of the Company's second quarter of 2000**. Beans again held

an “all hands” meeting in the provisioning center. Rosales reported that during this meeting, Beans stated that the Company was 160,000 lines short of its objective. Following this meeting, Beans again met with Mobley and Harry, but this time in Mobley’s office (also an open cubicle). He further reported that within thirty minutes of the “all hands” meeting, at least two sales support service managers, whose responsibilities included writing up sales orders that had been brought in by the Company’s sales force, approached Rosales and said they were specifically told by Beans to fabricate orders. When these service managers said they did not want to cooperate, they were both told that ICG “could find some else who would.” Eventually, at least one of the service managers agreed to enter the bogus line orders into ICG’s system, thereby adding them to ICG’s official reported line count for this quarter.

123. Adkins confirmed that Defendants fabricated line counts in another way. According to him, ICG’s official reported line count in the first and second quarters of 2000 included between 120,000 to 169,000 lines from various switch sites that had a maximum line capacity of 84,672 lines. The former Infrastructure Program Manager became aware of the Company’s practice when he became responsible for preparing weekly switch site audit reports in March of 2000. These audits were done by analyzing Automatic Message Accounting (“AMA”) billing tapes created by the Company’s Lucent switches, which were installed within ICG’s various switch sites.

124. According to Adkins, the weekly audit reports, which were prepared on Excel spreadsheets, were distributed to his supervisors, Fish - the Vice President of Finance, Robinson - the Infrastructure Program Director, Goedel - the Vice President of Engineering and Infrastructure, and Joseph Hurtado - the Senior Vice President of Telephony Operations. These weekly audit reports were broken down by switching module ("SM"), NPA-NXX and by the recorded call traffic within the course of the preceding week. The SM was a "cabinet" module within the switch that housed equal quantities of ports. The Lucent switch could house a maximum of nine SM cabinets.

125. According to Adkins, the former Infrastructure Program Manager, when the AMA billing tape results were compared to actual billing and line count information delineated within "ARTIS," the Company's internal billing and provisioning system, it was clear that ICG was over-assigning lines to individual switches, and then billing for many more lines than the given switch's maximum capacity could hold. In many cases, the number of lines billed exactly doubled the switch's capacity. Although bills were being generated for these artificial line counts, and revenue recorded on the Company's books, the actual bills were not sent out.

126. Adkins attested to the fact that Company executives were careful to respond to these audit reports verbally, and not in writing. In response to one particular audit report, Fish, the Company's Vice President of Finance, told the

Company's switch site auditor that "Bryan has always done this" and that Bryan had been artificially inflating the Company's line counts "for years."

f. "In" Lines

127. According to Adkins, lines were divided into two categories: (i) "out-lines," the lines sold to subscribers who used them to make calls out of the ICG network; and (ii) "in-lines," the lines that the RBOC/ILEC customers used to call into ICG subscribers. "Out-lines" generated revenues whereas "in-lines" were a cost to ICG.

128. According to Adkins, the Company's switch site audits also confirmed and proved that the Company, at Bryan's and Beans' direction (as expressed through the "executive meetings" and various informal meetings like those described above), double-billed for the Company's DS3 trunks, which are digital carrier facilities used to transmit DS3 formatted digital signals. Specifically, the Company inappropriately failed to account for its "in-lines" as costs, and instead, booked both the "in-lines" and the "out-lines" as revenue. As a result of this practice, during the Class Period, the Company's book-to-bill ratio consistently ranged between 20% to 25%, well below industry standards.

g. ISP "Free Lines"

129. Another practice employed to inflate ICG's line count involved the Company's effort to gain new business from ISP customers without disclosing to the market the incentives that ICG provided to obtain that business. ISPs successfully negotiated with ICG to receive a free line for each line they

purchased. The second line was used to ensure that the ISP customers would not experience any difficulties or delays when trying to call in and connect with the ISP server. According to Adkins, throughout the Class Period, ICG included the free-of-charge ISP lines on its DTOTS system. Because the ISP lines represented approximately 50% of the Company's total line count, and as many as half of those lines were "free," by this practice alone ICG's line count was inflated by as much as 25% during the Class Period.

G. Amid the Cancellation of Numerous Major ISP Contracts, ICG Can No Longer Hide Customer Complaints and Inflate Reported Line Counts

130. Defendants' focus on inflating line counts while concealing the combination of a failing network and continued customer service problems proved to be a fatal one for the Company. An article published in *The Wall Street Journal* on November 13, 2000, entitled, *Out of Line: How a Brash Provider of Internet Services Became Unplugged* (the "Wall Street Journal article"), quoted one former ICG employee as saying: "We took a network that was working fine, and expanded it tenfold, and it didn't scale up gracefully."

131. ICG's constant network breakdowns triggered an avalanche of customer complaints. According to Adkins, who interacted regularly with ICG's customer service group, by the end of 1999, ICG's ISP customers, including AOL, Microsoft Network, L.L.C. ("MSN"), WorldNet, UUNet, Inc. ("UUNet") and NetZero, Inc. ("NetZero") had become increasingly frustrated by ICG's network problems. According to Adkins, by early 2000, AOL, MSN, UUNet and NetZero were each threatening to withhold payments for lines to ICG if the daily network failures were

not corrected. These four customers alone represented between \$150-\$175 million of ICG's annual revenues. Other customers, such as the University of Southern California, University of California, Los Angeles Regents (Colorado Springs) and the City of Denver, also threatened to cancel their service as a result of ICG's failing network. Barry Zahn confirmed that many of ICG's major customers were canceling their accounts when he left in October 1999, and continued to cancel service at a rapid pace thereafter as a result of ICG's failing network.

132. The network failures and customer complaints continued throughout 2000. According to a November 13, 2000 *Wall Street Journal Article*:

ICG's ramps to the Internet superhighway were getting clogged, partly because too much traffic at times was sent to some of the ramps, causing the equivalent of massive traffic jams. Busy signals and dropped connections began skyrocketing as ICG wrestled with new equipment and an untested service. By early summer, the number of customers successfully linking to the network 'literally was falling off a cliff,' says Mr. Fetveit of Netzero. As the troubles continued, Netzero and others began routing their calls via rivals' networks – and not giving new business to ICG.

By summer, Microsoft, Netzero and Spinway Inc., the Internet-access company driving Kmart Corp.'s BlueLight.com online service, were all threatening to withdraw their business unless service improved. To patch up relations, ICG President William S. Beans, Jr. flew to Microsoft's headquarters in Redmond, Wash. He succeeded only temporarily, as Microsoft sent a letter to ICG in August threatening to terminate the account after service deteriorated further.

133. The *Wall Street Journal Article* summarized ICG's customer service problems as follows:

[ICG] overpromised and then underdelivered on its service, says Jon Fetveit, a vice president at customer Netzero. 'They tried to grow too fast,' he says, adding that ICG's poor service prompted NetZero to shift some business to ICG competitors.

134. ICG's investors, however, who had been fed a steady stream of false line count reports, remained oblivious to these mounting customer problems as they were taking place.

135. As a result, in the first and second quarters of 2000, these customers were refusing to pay for lines already purchased and installed. Their discontent caused ICG's, and Defendants Bryan's and Beans', fraudulent conduct to become exposed, because ISPs began to cancel hundreds and thousands of lines that they had ordered, but which had not yet been installed and which ICG falsely included in its previously reported line counts. Wall Street's expectations for ICG already took into account the falsely reported lines. When the ISPs refused to accept these lines, ICG's growth, in terms of line counts and revenues, abruptly stopped.

136. Adkins explained that ICG had no choice but to issue large credits to each of these major customers. Although the credits were substantial, ICG still was not reducing reported revenues to reflect these credits granted to these angry customers and, as described in paragraphs 108 to 113 above, Beans specifically instructed personnel not to book the cancelled lines until later dates. Although the credits were substantial, ICG was still not reducing revenues to reflect these credits granted to its customers.

137. Notwithstanding Bryan's and Beans' efforts, according to a former Infrastructure Program Manager, in August of 2000, AOL terminated its business relationship with ICG. Within a few months, MSN canceled its ICG contract. NetZero and UUNet ultimately canceled their respective contracts in late 2000. By the time these companies had canceled their ICG accounts, each owed the Company millions of dollars from payments they began withholding in April 2000. Each ISP thereafter continued to refuse to remit any payment for the outstanding balances ICG claimed to be owed. Nonetheless, ICG continued to bill these customers, and recognized revenue for the same.

THE RECIPROCAL COMPENSATION FRAUD

138. Defendants Bryan's and Beans' fraudulent practices during the Class Period were not limited to inflating line counts and concealing ICG's failing network. Bryan and Beans also recognized reciprocal compensation revenue purportedly owed to ICG by regional bell operating companies ("RBOCs") and incumbent local exchange carriers ("ILECs") that Bryan and Beans knew, or should have known, would never be paid to ICG.

139. The Federal Telecommunications Act of 1996 ("Telecommunications Act") made it possible for new competitors to enter the telecommunications market to lease lines at wholesale prices, which were then sold to customers to provide telephone/Internet services. The Telecommunications Act also provided for reciprocal compensation in some specific areas. For example, whenever an RBOC/ILEC customer made a

telephone call over a CLEC network to a CLEC customer, the RBOC/ILEC would be obligated to pay the CLEC a usage fee. In order for a CLEC to secure reciprocal compensation from the RBOC/ILEC, the CLEC was supposed to negotiate an “interconnect agreement” with the given ILEC/RBOC in which the ILEC/RBOC and the CLEC agreed to pay each other fees for their respective customer’s usage of the other’s telecommunications network.

140. Regardless of whether the parties had negotiated an “interconnect agreement,” the RBOC/ILEC was required by the Telecommunications Act to assist ICG with the interconnect hook-up process, which typically required several representatives of the given RBOC/ILEC to work full time at ICG’s switch site for approximately thirty (30) days. Indeed, in order for ICG to establish a switch site’s “connectivity” to the local area RBOC/ILEC, each of the switch’s 84,672 lines needed to be interconnected to the RBOC/ILEC, port by port. Each ICG switch site and/or Local Access and Transport Area (“LATA”) required a separate interconnect agreement to establish the right to reciprocal compensation and rates of payment.

141. According to Gardetto, a former ICG Infrastructure Program Manager, ICG went ahead with the switch site connections, even though in many cases it did not have interconnect agreements. According to her, ICG was focused on building out its network as rapidly as possible in order to increase its line counts and reported revenues. Only then would ICG start pursuing the RBOCs/ILECs for reciprocal compensation. To this end, ICG made deals with Lucent and Cisco to

secure vendor financing for ICG to build out the Company's network. ICG dramatically increased line counts and reported revenues in this manner.

142. According to John Colgan, a former Senior Vice President of Finance and Colorado Controller, even in those instances where ICG had an interconnect agreement with an RBOC/ILEC, the RBOC/ILEC was reluctant to pay because of the uncertain regulatory environment surrounding reciprocal compensation. He further reported that many of the RBOCs/ILECs took a "wait and see" posture as to whether the regulatory authorities would require payment under such contracts. To make payment even less certain, many RBOCs/ILECs were claiming that the contracts themselves were ambiguous as to the fundamental meaning of "reciprocal compensation." For example, according to Colgan, many RBOCs/ILECs cited this ambiguity as a means of refusing to pay reciprocal compensation for ISP traffic under the terms of the interconnect agreements. As it did with other "reciprocal compensation" revenue that was unlikely to be collected, ICG nonetheless recognized revenue from such traffic during the Class Period.

143. ICG improperly booked substantial reciprocal compensation revenue in 1999 and 2000, despite the fact that payment was highly unlikely. Specifically, ICG recorded \$30,800,000 in reciprocal compensation revenue in the fourth quarter of 1999 and \$35,500,000 in reciprocal compensation revenue in the first quarter of 2000.

144. ICG's recognition of such reciprocal compensation revenues was improper and Defendants knew it. The determination as to whether ICG could recognize reciprocal compensation revenue was supposed to be based upon the "more likely than not" standard. In other words, if it was more likely than not that the money would be collected from the RBOCs/ILECs, then ICG could recognize the revenue. By year-end 1999, however, it was clear to Defendants that collection was extremely uncertain, because even the RBOC/ILEC customers who had interconnect agreements with ICG were not paying for their usage of ICG's network, let alone the majority of RBOCs/ILECs who were not under contract to pay. Overall, actual collections from the RBOC/ILECs during the Class Period totaled a fraction of what ICG had billed them.

145. According to Cindy Schonhaut, the Company's Executive Vice President of Governmental Affairs, who was specifically responsible for regulatory issues regarding reciprocal compensation revenue and related PUC and FCC rulings, Defendants Bryan and Beans knew that ICG was improperly booking reciprocal compensation revenue in 1999 and 2000. In a series of internal company memoranda dated in 1998, 1999 and 2000, she documented her opinion that ICG should not be recognizing revenue from reciprocal compensation agreements because it was extremely unlikely that such revenue would ever be collected. ***Defendants Bryan and Beans, as well as various other Company Vice Presidents, received all of her memoranda.***

146. The memoranda circulated by Ms. Schonhaut also addressed the complete inadequacy of the reserves for uncollectible accounts (“reserves”) against the revenue recognized. Despite the fact that other companies similar to ICG reserved 100% of the claimed reciprocal compensation revenue, due to the significant uncertainty of collection, and the fact that RBOCs/ILECs were not paying, ICG reserved for only about half of the total revenue recorded. Schonhaut concluded in her memoranda that the reciprocal compensation revenue should not have been recognized at all and, if it was to be recognized, the reserve was far too low. As a result, ICG’s gross profit and EBITDA were materially and grossly overstated during the Class Period.

147. This revenue recognition practice also contravened the Company’s statements in its Quarterly Reports filed on Form 10-Q for the first quarter of 2000 (p. 15), in which the Company falsely represented that the reciprocal compensation revenue recorded reflects “transport and termination of local traffic to ISPs from customers of RBOC/ILECs pursuant to various interconnection agreements.” In fact, in many cases ICG did not have interconnect agreements with most of the RBOC/ILECs but went ahead and billed for and booked the revenue anyway.

FALSE AND MISLEADING STATEMENTS

148. Throughout the Class Period, Defendants Bryan and Beans made numerous misrepresentations and omissions concerning ICG’s line counts, revenues and network capabilities. These false and misleading statements

inflated the value of ICG's stock, which was valued by the market on the basis of, among other things, the Company's reported line counts and related network-based revenues. The following are the false and misleading statements made by Defendant Beans and Bryan during the Class Period:

Fourth Quarter 1999 False and Misleading Statements:

Defendants' December 9, 1999 Statements

149. On December 9, 1999, at 9:00 AM MST, Defendants Bryan and Beans hosted a conference call for financial analysts. During that conference call they stated that ICG's fourth quarter 1999 performance would meet or exceed the earnings estimates previously published by the financial analyst community, and was on track to report break-even EBITDA for full-year 1999. In addition, Bryan and Beans said that ICG would install 115,000 or more lines and ports in the fourth quarter, and emphasized ICG's strong sales of 400,000 to 450,000 of RAS/IRAS ports to major ISP customers, with another 200,000 ports to be announced shortly. As reported in the First Union analyst's report issued at 7:56 a.m. on December 10, 1999, Bryan and Beans also made revenue projections: "An additional point that ICG made on the call was the approximately 770,000 ports that the Company has contracts for to date will provide an estimated \$300 million in fixed payments to ICG (this excludes reciprocal compensation that is driven off these ports)." Defendants Bryan's and Beans' positive report regarding ICG's line sales had a favorable impact on Wall Street analysts' valuations.

150. Bryan's and Beans' December 9, 1999 statements were relied on by Wall Street analysts and cited in publicly available analyst reports. For example, on December 10, 1999, Deutsche Banc Alex Brown issued an analyst's report entitled "Full Steam Ahead," in which it made a "Strong Buy" recommendation on ICG's stock based on the Company's representations that it had more than 500,000 lines in service, and that it "had already sold nearly 80% of the previous guidance of 700,000 installed lines by year end 2000." As highlighted by the Deutsche Banc report of the same day, "[t]he majority of these lines [were] in multi-year (average 3-5 year contracts) RAS and IRAS ports...." that the Company had purportedly sold to ISPs. The analyst from Deutsche Banc went on to praise ICG's "ultra-conservative approach to recording reciprocal compensation revenues, and a selling machine that just won't quit."

151. Similarly, on January 7, 2000, Morgan Stanley Dean Witter published its report of a meeting that morning with Beans and Bryan, titled "IC Upside." The report concluded: "Our confidence level for both near and longer-term projections has risen significantly. We continue to rate the shares Strong Buy: our price target is \$32." In addition to the report's description that Beans "appears extremely competent with great operational experience," the key points from the meeting were:

- 1) ICG's 4Q99 results are on track and management is very comfortable with a 2000 EBITDA estimate of \$150M (versus our estimate of \$140M) . . .
- 2) There will be no change in ICG's business strategy . . .

- 3) ICG has been meeting with private equity investors, which could potentially lead to opportunities in the near future.
- 4) We believe ICG is close to receiving vendor financing and it could hear more on these developments in the near term.

Fourth Quarter 1999 Results

152. On February 29, 2000, ICG issued a press release reporting its results for the fourth quarter and year-end of 1999. ICG announced that it “installed a record 133,000 net business access lines and Internet service provider (ISP) ports during the fourth quarter, bringing the year-end total to 731,000, more than double the year-end 1998 total.” The Company announced that 80 percent of the lines provisioned during the year were “for Internet access ports for ISP customers, where ICG’s National network and excellent customer service have enabled the Company to capture an increasing share of this new, high growth market.” Fueled by the rapid line expansion, the Company reported full year revenues of \$479.2 million, reflecting 58% growth over 1998. Local services revenue of \$299.9 million in 1999 accounted for 63% of the total revenue, and included revenue from ISP customers, business customers for local services, and reciprocal compensation charges for call termination. The local service revenue increased 88% from the prior year. The Company stated that ICG’s “higher gross operating margin is due to increased volume on ICG’s network that greatly improved network efficiency, and higher margin per line/port from remote access services and special access services.” ICG also touted its efficiencies by

referencing the “upgrade of the Company’s operating support systems with the installation of a state-of-the-art billing system.”

153. ICG’s management continued to assure the investment community that its business remained strong, and that it would report sequential growth in revenue and EBITDA. Defendant Bryan was quoted in the February 29, 2000 press release as follows:

During 1999, **we demonstrated remarkable growth in terms of revenue, lines in service and network capability.** We initiated an aggressive plan to expand our national network, extended our product portfolio through alliances with broadband and application providers, and added substantial management expertise. Yesterday, we announced \$750 million in equity financing and today additional vendor financing that brings total capital raised year-to-date to nearly \$1.2 billion. These actions clearly position ICG to deliver accelerated growth in 2000 and meet the changing telecommunications needs of our customers.

(emphasis added.)

154. The same press release promoted the Company’s expanding network:

Long-term contracts signed [in 1999] with major Internet companies such as The Microsoft Network, L.L.C., Spinway.com, Netzero, Inc. and several others, illustrate ICG’s leadership among Internet infrastructure providers. Through the year, sales to ISPs transitioned from basic Internet access services to remote access services, which better employ the capabilities at the ICG hub to manage and route Internet traffic. **By providing more advanced network services for its ISP customers, ICG increases revenue per line, minimizes the ISP’s capital outlay and improves the quality of service to the end-user.**

(emphasis added.)

155. On or about March 30, 2000, the Company filed with the SEC its 1999 Form 10-K, which was signed by Defendant Bryan and approved by

Defendant Beans. The 1999 Form 10-K contained the statements made on February 29, 2000 (including the Company's "record" line counts and revenue) and continued to highlight the Company's rapid network expansion and alleged technical capabilities. Just as their statements of line counts, revenue and technological prowess were false when made on December 9, 1999, they were false when made in connection with the Company's publicly reported results for the fourth quarter of 1999.

156. In addition to the Company's false report with regard to its network capability and reliable customer service, the February 29, 2000 press release and the 1999 Form 10-K also highlighted that the Company's local services revenues had increased 88% from the year before, from \$159.2 million for the year ended December 31, 1998 to \$299.9 million for the year ended December 31, 1999. As a result, local services revenue now made up 63% of the Company's total revenue, compared to only 52% in the year before. According to the 1999 Form 10-K, "the increase in local service revenue is primarily due to an increase in the number of customer service lines in service from 354,482 at December 31, 1998 to 730,975 lines at December 31, 1999."

157. The statements set forth in ¶¶ 149 and 152-156 above were materially false and misleading because, among other reasons:

- As set forth above in ¶¶ 85-129, by no later than the fourth quarter of 1999 and continuing until the end of the Class Period, Defendant Beans and Bryan decided to artificially inflate ICG's lines counts. For example, as set forth ¶¶ 87 and 88, whenever ICG needed a change in line counting methodology to meet a particular quarter's line count projections, Beans would simply take every column of Nancy

Hoag's line count spreadsheets, including columns for lines that would not be installed for months, and add them together.

- As set forth in ¶¶ 91-96, 98-100, 105-107, 108-109 and 114, by no later than December 1999, Defendants Bryan and Beans caused ICG to inflate line counts in the following ways: (1) by selling discounted lines, delaying billing, and even offering free lines; (2) by pushing line count cancellations into future quarters; and (3) by adding various types of non-revenue-producing lines into ICG's DTOTS database. Dibiase and Elmont stated that these practices were prevalent at ICG in the fourth quarter of 1999.
- As set forth in ¶ 93, Beans told Dan Rosales and other Technical Consultants only weeks before the close of the fourth quarter that "You will create lines. You have three days." The Technical Consultants responded by creating lines.
- As set forth in ¶ 102, Jim Adkins, who audited various ICG switch sites, stated that audit reports and subsequent investigations shown to ICG's senior management demonstrated that approximately 75% of the lines entered into the DTOTS database during the Class Period were phony.
- As set forth in ¶¶ 109 and 110, the practice of not removing cancelled lines resulted in ICG's fourth quarter line count being inflated by between 30,000 to 50,000 lines.
- As set forth in ¶¶ 65-77, by December 1999, ICG's network was failing and that as a result of the network's ongoing problems, ICG was unable to continue to rapidly grow its line counts going forward. According to Zahn, Beans ordered the roll out of ICG's RAS service using the Lucent 5ESS switch knowing that it did not work properly. Accordingly, Defendants knew that the lines they sold to the ISPs were worthless without improvement to the network. Nevertheless, Defendants omitted this information during the December 9, 1999 conference call and when it reported its fourth quarter results, while falsely touting the success of its network.
- As set forth in ¶ 131, according to Barry Zahn, many of ICG's major customers were canceling their accounts when he left in October 1999, and continued to cancel service at a rapid pace thereafter as a result of ICG's failing network. Defendants Bryan and Beans omitted this fact during the December 9, 1999 conference call and in ICG's fourth quarter results.
- As set forth in ¶ 145, Cindy Schonhaut, the Company's Executive Vice President of Governmental Affairs, circulated internal company memoranda in 1999 to Defendant Beans and Bryan in which she documented her opinion that ICG should not be recognizing revenue from reciprocal compensation agreements because it was extremely unlikely that such revenue would ever be collected. The revenue reported

in ICG's fourth quarter results included reciprocal compensation revenue that, according to Schonhaut's memos, was improperly booked by ICG.

First and Second Quarter 2000 False and Misleading Statements:

First Quarter 2000 Results

158. On April 26, 2000, ICG issued a press release announcing its results for the first quarter of 2000, reporting results "that reflect another record for access lines installations, adding 174,000 lines for its ISP and business customers." The Company also announced that first quarter of 2000 revenue was \$157.2 million, an increase of \$52.9 million, or 51%, over the first quarter of 1999, and EBIDTA of \$19.2 million, a 144% increase over the comparable period in 1999. In the Company's press release, Bryan continued to assure investors that the Company was "right on track to meet [its] commitments."

159. On or about May 12, 2000, ICG filed with the SEC its Form 10-Q for the first quarter of 2000. Defendants Bryan and Beans approved the Form 10-Q. The first quarter of 2000 Form 10-Q reported the same overstated line counts and inflated revenue as announced in the Company's April 26, 2000 press release. Additionally, the Company's first quarter of 2000 Form 10-Q misrepresented that "based on revenue and customer lines in service, [ICG was] one of the largest competitive communications companies in the United States." Again, the Company highlighted the growth in local services revenue, which had increased from \$67.4 million (or 65% of total revenue) for the three months ended March 31, 1999 to \$102.6 million (or 65% of total revenue) for the three months ended March

31, 2000, “primarily due to an increase in the local access lines at March 31, 1999 as compared to those in service at March 31, 2000.”

160. The markets reacted favorably to ICG’s reports, and the stock price more than doubled in the next two months.

ICG’s August 1, 2000 Statement

161. On August 1, 2000, the Company announced the Colorado, California and Ohio launch of its integrated access product, iConverge. The press release continued to tout ICG’s network:

With a powerful, end-to-end Cisco Powered Network, ICG is able to provide its customers with high-performance, customer-focused, reliable, and secure network services.

162. The August 1, 2000 statement was false when made. As Defendants knew, ICG was not able to provide its customers with high-performance, customer-focused, reliable, and secure network services. Due to the Company’s inadequate network, ICG was forced to issue substantial credits to the Company’s largest ISP customers, including AOL, MSN and NetZero. As the Company’s network failures continued, in April 2000, the Company’s largest ISP customers stopped making payments to ICG. The last payment ICG received from AOL, MSN, UUNet or NetZero was in March, 2000.

Second Quarter 2000 Results

163. On August 10, 2000, ICG reported its results for the second quarter of 2000, ended June 30, 2000. The Company reported revenue and EBITDA below analysts’ expectations. Specifically, the Company reported that second

quarter of 2000 revenue totaled \$175.8 million, an increase of \$58.1 million, or 49%, over the second quarter of 1999, and EBITDA of \$23.5 million, an increase of \$8.3 million, or 55%, over the comparable period in 1999. However, there was a one-time reciprocal compensation related benefit, and the calculation of normalized EBITDA showed it was 38% below the forecast. Furthermore, the rates of compensation for some newly negotiated reciprocal compensation agreements were for incredibly low rates, down to even less than \$0.001 per minute, reflecting ICG's acknowledgment of the weakness of its claims for payment.

164. Still, Defendants continued to conceal the Company's pervasive network failures and customer complaints and continued to falsely inflate ICG's line counts. Instead, the same press release quoted Defendant Bryan as follows:

I believe we have set records for our peer group with our team's outstanding effort to install 208,000 lines and deploy eight new switches during one quarter. We are very pleased with the operational progress of our 2000 expansion plan. Concurrently, we launched iConverge and DSL and initiated service over our extensive VoIP network for unified messaging, all of which have excellent future growth potential. Further, we have reached an agreement with an incumbent telephone company that establishes reciprocal compensation rates for three years, providing certainty of revenue in the majority of our markets.

(emphasis added.)

165. On or about August 14, 2000, ICG filed with the SEC its Form 10-Q for the second quarter of 2000. Defendants Bryan and Beans approved the Form 10-K. The second quarter of 2000 Form 10-Q reported the same artificially inflated revenue as announced in the Company's August 10, 2000 press release.

166. The statements set forth in ¶¶ 158, 159, 161, and 163-165 above were materially false and misleading because, among other reasons:

- As set forth above in ¶¶ 85-129, throughout the first and second quarters of 2000, Defendant Beans and Bryan decided to artificially inflate ICG's lines counts. For example, as set forth in ¶¶ 87 and 88, whenever ICG needed a change in line counting methodology to meet a particular quarter's line count projections, Beans would simply take every column of Nancy Hoag's line count spreadsheets, including columns for lines that would not be installed for months, and add them together.
- As set forth in ¶¶ 98, 100, throughout the first two quarters of 2000, Defendants Bryan and Beans artificially boosted ICG's line counts in the following ways: (1) by selling discounted lines, delaying billing, and even offering free lines; (2) by pushing line count cancellations into future quarters; and (3) by adding various types of non-revenue-producing lines into ICG's DTOTS database. Dibiase and Elmont stated that these practices were prevalent at ICG in the first quarter of 2000. Adkins confirmed that these practice were also prevalent in the second quarter of 2000.
- As set forth in ¶ 109, Dibiase stated that he was instructed by Defendant Beans and Bryan not to remove cancelled lines from the DTOTS system in the first quarter of 2000.
- As set forth in ¶113, Adkins stated that, **as late as May 2000**, ICG was "double booking" accounts previously serviced by the frame relay network.
- As set forth in ¶¶ 115 to 116, Staci Ann Gardetto stated that during the first and second quarters of 2000 ICG's Vice President of Engineering and Infrastructure, Mike Goedel, told her that Beans had instructed him to add uninstalled lines to the DTOTS database. With respect to at least one large order in either the first or second quarter of 2000, she recalled that ICG added between 20,000 and 30,000 uninstalled lines into the DTOTS system, thereby including them in ICG's official reported line count.
- As set forth in ¶ 119, according to Virginia Cash, a former Vice President of Colorado Service and Business Network Systems, as pressure to meet Wall Street's expectations increased in early 2000, and ICG's ability to legitimately meet those expectations waned, senior management began to include lines that were not even scheduled to be installed until the next quarter or had no planned installation date whatsoever. Cash further reported that she was "absolutely certain" that this practice, among others, significantly inflated ICG's line counts in the first quarter of 2000.

- As set forth in ¶¶ 120-126, according to Dan Rosales, the Company's wholesale group was told by Beans to write orders for 25,000 to 50,000 lines, regardless of whether a purchaser or ISP was involved. According to Rosales, a service manager entered 160,000 bogus line orders into ICG's system, thereby adding them to ICG's official reported line count. According to Adkins, ICG's official reported line count in the first and second quarters of 2000 included between 120,000 to 169,000 lines from various switch sites that had a maximum line capacity of 84,672 lines.
- As set forth in ¶¶ 131-133 and 137, by early 2000, AOL, MSN, UUNet, and NetZero were each threatening to withhold payments for lines to ICG if the daily network failures were not corrected, and AOL terminated its relationship with ICG in August 2000. Defendants Bryan and Beans failed to disclose these customer problems in any of the Company's first or second quarter 2000 Statements.
- As set forth in ¶ 145, Cindy Schonhaut, the Company's Executive Vice President of Governmental Affairs, circulated internal company memoranda in 2000 to Defendant Beans and Bryan in which she documented her opinion that ICG should not be recognizing revenue from reciprocal compensation agreements because it was extremely unlikely that such revenue would ever be collected. The revenue reported in ICG's fourth quarter results included reciprocal compensation revenue that, according to Schonhaut's memos, was improperly booked by ICG.

THE TRUTH EMERGES

167. On August 10, 2000, after the Company issued its financial results for the second quarter of 2000, the Company hosted a conference call for analysts and investors, during which ICG management lowered the Company's EBITDA expectations for the second half of 2000 and all of 2001, forecasting EBITDA of \$105 million for 2000, or \$45 million less than expected, and \$350 million for 2001, \$100 million less than expected. These figures fell well below analysts' expectations. For example, Ken Hoexter of Merrill Lynch & Co. had previously forecast EBITDA of \$150 million for 2001 and \$450 million for 2001. The same day, the Company announced the sudden resignation of Pamela Jacobson, the Company's Executive Vice-President of Sales and Marketing.

168. As a result of these disclosures, the Company's stock lost 53.95 % of its value in a single day, closing at \$6.5625, on volume of 25 million shares.

169. On August 22, 2000, ICG announced that Bryan had resigned his position as Chairman and CEO. The Company's Board of Directors elected Vogel to replace Bryan as the Company's Chairman and CEO. Vogel, a Senior Vice President of Liberty Media, had been a Director of the Company since April 2000, after Liberty Media invested \$500 million in the Company.

170. On September 18, 2000, ICG belatedly revealed the problems with its network and customer complaints, making the following announcement:

ICG Communications, Inc. today announced a revised business plan in order to conserve cash resources, **address serious customer service issues that have arisen and for other reasons.**

The revised business plan calls for **controlled expansion, quality of service enhancements** and cost savings. The new plan anticipates that for the remainder of 2000 and in 2001 the Company will experience reduced capital and corporate expenditures, **slower expansion, significantly lower line installations**, lower overhead costs and significantly reduced revenues and EBITDA. . . .

Recently, ICG has experienced significant customer service issues within certain segments of its Internet Remote Access Service, or IRAS, business that represents significant portions of revenues. **These issues have involved, among other things, network outages, equipment failures and technical difficulties.** As a result, some of its IRAS customers, including certain principal customers, have advised ICG that it is not in compliance with service agreements. Some of these customers have reduced their commitments to ICG. These customers have indicated that, absent these issues being resolved, they intend to terminate their contractual arrangements with ICG.

As a result of these quality of service issues, **the Company expects to receive minimal revenues in the third quarter and fourth quarters of this year from IRAS services with respect to approximately 150,000 installed IRAS lines. Some customers have also significantly slowed**

adding lines, which, along with other factors, will significantly adversely affect the number of lines provisioned by the Company in the third and fourth quarters of 2000.

(emphasis added.)

171. On September 18, 2000, the price of ICG's common stock fell \$2.25, or 58%, to \$1.66 per share, on volume of 23 million shares exchanged, more than 11 times the three-month daily average. The closing price of ICG common stock following these announcements represented a 95% decrease from the Class Period high of \$39.00 per share on March 27, 2000.

172. The next day, September 19, 2000, Vogel resigned as Chairman of the Board of Directors and as CEO of the Company. Board members Gary Howard and Thomas Hicks, who also had joined the Company's Board in connection with the \$750 million investment in the Company only months before, also resigned.

173. On November 14, 2000, ICG filed for Chapter 11 bankruptcy protection from creditors. On November 18, 2000, the NASDAQ de-listed the Company's stock.

ADDITIONAL SCIENTER ALLEGATIONS

174. As set forth in detail in ¶¶ 85 to 129, numerous witnesses have confirmed that both Defendants Bryan and Beans knew, or at the least, were reckless in not knowing that during the Class Period ICG was issuing false and misleading statements regarding the Company's line count, the condition of its network and the amount of reciprocal compensation which the Company expected

to receive from RBOCs/ILECs. In addition to those detailed allegations of Bryan's and Bean's scienter, Lead Plaintiffs allege the below additional allegations that establish that Defendants knew or should have known that the statements in ¶¶ 149, 152-156, 158, 159, 161, and 163-165 were false and misleading.

175. As set forth in ¶¶ 76 to 84, Defendants Bryan's and Beans' receipt of the RBO transcript of ICG's August 27, 1999 employee focus group supports a strong inference of their scienter with respect to the following:

- a. Defendants knew or recklessly disregarded the fact, that ICG's network was not functioning close to the manner that they had described to the public. Specifically, Defendants knew that line installations were repeatedly and unacceptably delayed, that the Company's billing function was not working properly, and that post-sale customer service was non-existent;
- b. Defendants knew or recklessly disregarded the fact, that, as a direct consequence of the Company's network failure, ICG's customers were lodging constant complaints. Defendants further knew that, in many cases, customers were canceling their service as a result of ICG's poor service; and
- c. Defendants knew or recklessly disregarded the fact, that ICG's line counts were inflated because they improperly included lines that were not yet, or could not ever, be installed.

176. As set forth in ¶¶ 85 to 129, Defendants Bryan's and Beans' participation in ICG's weekly "executive team" meetings, and the specific statements by Beans and Bryan to their subordinates, supports a strong inference of their scienter with respect to the following:

- a. Defendants knew, or were reckless in disregarding the fact, that ICG's line count improperly included lines that that were "sold" to customers at discount rates or with "delayed billing" arrangements by which the lines would never produce revenue, and, in some cases, would never even be installed;

- b. Defendants knew, or were reckless in disregarding the fact, that ICG's official reported line count included cancelled lines that were not removed from ICG's billing system in the quarter in which they were cancelled;
- c. Defendants knew, or were reckless in disregarding the fact, that ICG's official reported line count improperly included internal lines installed within the Company that would never produce any revenue;
- d. Defendants knew, or were reckless in disregarding the fact, that ICG's official reported line count included cost lines as if they were revenue lines;
- e. Defendants knew, or were reckless in disregarding the fact, that ICG's official reported line count included non-existent lines from switches whose maximum capacity was only about half the number of lines attributed to them in ICG's reported line counts;
- f. Defendants knew, or were reckless in disregarding the fact, that ICG's official reported line count included "double-booked" lines from many long-term customers that had formerly been serviced by the Company's frame relay network after it was phased out in 1998, when ICG switched over to the NETCOM network. When the switch to NETCOM occurred, the Company continued to count monthly line and revenue associated with the old frame relay network, as if customers were still being serviced on it; and
- g. Defendants knew, or were reckless in disregarding the fact, that ICG recorded revenue on lines that had been provided to ISP customers free of charge.

177. As set forth in ¶¶ 62-75, 92-93, 130-137, and 138-147, the following additional facts also support a strong inference that Defendants Bryan and Beans acted with scienter:

- a. In the summer of 1999 and throughout the Class Period, Defendants knew, or were reckless in disregarding, that ICG did not have a sufficient network to provide the services it promised its ISP customers. Defendants Bryan and Beans knew that the Cisco series 5800 and 6700 routers the Company had purchased for integration with the Company's RAS and IRAS circuits had a software "glitch" that caused the communication between the routers and switches to completely shut down and that ICG was unable to fix its networks despite continuous efforts to do so throughout 1999 and 2000;

- b. Defendants knew of, or were reckless in disregarding, the numerous complaints from customers in 1999 regarding ICG's services, and knew by early 2000 that AOL, MSN, UUNet and NetZero were threatening to withhold payments to ICG if the daily network failures were not corrected, and they knew that ICG issued substantial credits to each of these major customers in response to their complaints;
- c. Defendants knew, or were reckless in disregarding, that ICG was unable to meet 80% of its guaranteed completion levels to MSN, requiring ICG to pay substantial penalties to MSN each month;
- d. Defendants knew or were reckless in disregarding the fact that the last payment ICG received from AOL, MSN, UUNet or NetZero was in March of 2000 and yet the Company did not disclose any dispute and continued to recognize approximately \$38 million in revenue each month for the remainder of the Class Period from these combined accounts, without setting aside a reserve for the possibility that these customers would never pay;
- e. Defendants knew, or were reckless in disregarding the fact, that the Company was going to fall short of analysts' line count expectations for the fourth quarter of 1999, and the first and second quarters of 2000 and that Beans instructed the Company employees to "create lines" or risk losing their jobs. Beans also said to Dibiase, "I don't give a (expletive) if you've got to give them away, just make the (expletive) line count." The improper inflation of lines allowed Defendants and the Company to meet Defendants' representations and Wall Street's expectations for line counts and revenue during those quarters; and
- f. Defendants knew, or were reckless in disregarding the fact, that ICG's strategy was to connect switch sites prior to pursuing the RBOCs/ILECs for reciprocal payment, thus dramatically increasing the Company's line counts and revenues, despite the fact that it was more likely than not that reciprocal compensation payments from the RBOCs/ILECs would not be forthcoming because the RBOCs/ILECs were refusing to pay; and knew of, or were reckless in disregarding, the numerous written objections from ICG's Executive Vice President of Governmental Affairs that were sent to them in 1998, 1999 and 2000, which stated that ICG should not have recognized such reciprocal compensation revenue.

178. As set forth in ¶¶ 55-61, Defendants' motivation of securing capital for ICG's attempted expansion into the national ISP market also supports a strong inference that they acted with scienter. Indeed, as a direct result of Defendants'

fraudulent conduct, ICG was able to secure such financing to expand its network: On February 28, 2000, ICG announced it was raising \$750 million in new capital from investors that included affiliates of Liberty Media, Hicks Muse and Gleacher. According to the Company's press release:

This investment, in combination with recent vendor financing, raises nearly \$1.0 billion and fully funds ICG's capital program for 2000. This capital will enable ICG to accelerate its national network expansion plans as well as revenue and EBITDA growth. Liberty will invest \$500 million, Hicks Muse \$230 million and Gleacher \$20 million. The investors are purchasing 8% convertible preferred stock and warrants. The transaction is expected to close within 60 days, subject to customary closing conditions.

179. According to the February 28, 2000 press release, the new funds were to be used for ICG's expansion plans into 16 new major metropolitan areas, to add an estimated 850,000 access lines and ports, and to purchase equipment and facilities required to execute the company's business strategy. Following the announcement of the capital investment by Liberty Media, Hicks Muse and Gleacher, securities analysts promoted ICG's business plan. For example, Mark Bacurin, an analyst with J.C. Bradford & Co., opined that the "announcement gives (ICG) the capital to go out and execute their business plan," adding that the financing "adds credibility to the business plan and addresses one of the biggest perceived risks to investors, which is the inability to fund growth."

180. On February 29, 2000, the Company also announced that it had signed a vendor financing commitment letter with Lucent to provide financing to fund the expansion of ICG's network. The release further provided that the deal was valued up to \$250 million.

181. Defendants Bryan and Beans knew that without hundreds of millions of dollars in additional capital, ICG could not complete its transformation from a traditional CLEC to a major provider of network services to the Internet industry. In order to obtain this capital on favorable terms, Defendants Bryan and Beans needed to increase Wall Street's valuation of ICG's business and its common stock. Bryan and Beans succeeded in inflating ICG's stock price and obtaining over a billion dollars in capital by falsely inflating ICG's line counts and resulting revenues, the primary metric driving Wall Street's assessment of ICG's business success. By the time Bryan and Beans obtained this capital, however, ICG's improper line sales practices and conscious neglect of customer complaints and network problems had escalated beyond the point of repair. As a result of numerous ISPs canceling their contracts with ICG in August 2000, Bryan's and Beans' effort to engage in fraud to obtain needed capital and to then use that capital to hide their fraudulent conduct failed.

CLASS ALLEGATIONS

182. Lead Plaintiffs bring this action as a class action pursuant to Federal Rules of Civil Procedure 23(a) and 23(b)(3) on behalf of a class (the "Class") of all persons who purchased ICG common stock on the open market between December 9, 1999 through September 18, 2000, inclusive (the "Class Period"), and who were damaged thereby. Excluded from the Class are: Defendants herein; ICG and all of its subsidiaries, affiliates, successors and assigns and any person who was a partner, officer, executive or director of any

such entity at any time for December 9, 1999 through the date of the Complaint; members of the families of each of the defendants; Liberty Media, Hicks Muse and Gleacher and their legal affiliates, partners, officers, employees, executives, directors, representatives, heirs, controlling persons, successors, and predecessors in interest or assigns of any of them; any entity in which any such excluded person has a controlling interest; and the legal representatives, heirs, successors and assigns of any such excluded person or entity.

183. The members of the Class are so numerous that joinder of all members is impracticable. While the exact number of Class members is unknown to Lead Plaintiffs at the present time and can only be ascertained from books and records maintained by ICG, its agent(s), and securities brokerage firms and financial institutions, Lead Plaintiffs believe that Class members number in the thousands. As of March 27, 2000, the Company had 48,582,035 shares of common stock issued and outstanding. During the Class Period, ICG's common stock traded on the NASDAQ National Market System, an efficient national market. During the Class Period, ICG was followed and reported on by analysts at numerous securities firms, including PaineWebber, First Union, A.G. Edwards & Sons, Inc., Deutsche Banc Alex Brown, Goldman Sachs, Salomon Smith Barney, Merrill Lynch, Morgan Stanley, Warburg Dillon, CIBC, Jefferies & Co., Bear Stearns, Prudential and Credit Suisse.

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

- a. Whether the federal securities laws were violated by Defendants' acts and omissions as alleged herein;
- b. Whether Defendants participated in and pursued the common course of conduct and fraudulent scheme complained of herein;
- c. Whether the documents, reports, filings, releases, and statements disseminated to the Class by Defendants during the Class Period misrepresented material facts about the business, performance, and financial condition of ICG;
- d. Whether Defendants acted knowingly or with deliberate recklessness in misrepresenting material facts;
- e. Whether the market price of ICG common stock during the Class Period was artificially inflated due to the misrepresentations complained of herein; and
- f. Whether plaintiffs and the other members of the Class have sustained damages and, if so, the appropriate measure thereof.

185. Lead Plaintiffs will fairly and adequately represent and protect the interests of the members of the Class. Lead Plaintiffs have retained competent counsel experienced in class and securities litigation and intend to prosecute this

action vigorously. Lead Plaintiffs are members of the Class and do not have interests antagonistic to, or in conflict with, the other members of the Class.

186. Lead Plaintiffs' claims are typical of the claims of the members of the Class. Lead Plaintiffs and all members of the Class purchased ICG common stock during the Class Period at artificially inflated prices and have sustained damages arising out of the wrongful course of conduct alleged herein.

187. A class action is superior to other available methods for the fair and efficient adjudication of this controversy. Since the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it virtually impossible for the Class members to individually seek redress for the wrongful conduct alleged. Lead Plaintiffs know of no difficulty that will be encountered in the management of this litigation that would preclude its maintenance as a class action.

**APPLICABILITY OF PRESUMPTION OF RELIANCE:
FRAUD-ON-THE MARKET DOCTRINE**

188. Lead Plaintiffs will rely, in part, upon the presumption of reliance established by the fraud-on-the-market doctrine in that, among other things:

- a. ICG and Defendants made public misrepresentations and/or failed to disclose material facts during the Class Period;
- b. The omissions and misrepresentations were material;
- c. The Company's common stock traded in an efficient market;
- d. The misrepresentations alleged would tend to induce a reasonable investor to misjudge the value of the Company's common stock; and

- e. Lead Plaintiffs and other members of the Class purchased ICG common stock between the time ICG and Defendants misrepresented or failed to disclose material facts and the time the true facts were disclosed without knowledge of the misrepresented or omitted facts.

189. At all relevant times, the markets for ICG common stock were efficient for the following reasons, among others:

- a. ICG met the requirements for listing, was listed and its stock was actively traded on the NASDAQ, an efficient national market;
- b. As a regulated issuer, ICG filed periodic public reports with the SEC and the NASDAQ; and
- c. ICG regularly communicated with public investors via established market communication mechanisms, including through the regular disseminations of press releases on the major newswire services and through other wide-ranging public disclosures, such as communications with the financial press and other similar reporting services.

190. Based upon the foregoing, the market for ICG common stock promptly digested current information regarding the Company from the publicly available sources described herein and reflected such information in the Company's stock. Under such circumstances, all purchasers of ICG common stock on the open market during the Class Period suffered similar injury due to the fact that the price of ICG common stock was artificially inflated throughout the Class Period. As a result, the presumption of reliance applies.

CLAIMS FOR RELIEF

CLAIM I

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

191. Lead Plaintiffs repeat and reallege each of the allegations set forth in the foregoing paragraphs. This Count is brought pursuant to Section 10(b) of the Exchange Act, 15 U.S.C. §78j(b), and Rule 10b-5, 17 C.F.R. §240.10b-5, promulgated thereunder, on behalf of all purchasers of ICG common stock on the open market during the Class Period.

192. Throughout the Class Period, ICG, Bryan and Beans, individually and in concert, directly and indirectly, by the use and means of instrumentalities of interstate commerce and/or the U.S. mails, made a series of false and misleading statements and omissions, all of which caused the market price of ICG common stock to be artificially inflated throughout the Class Period. Their conduct was either intentional and knowing, or extremely reckless in disregard for the truth, and had the effect of inflating ICG's publicly reported line counts and financial results and concealing ICG's pervasive network and customer service problems.

193. Specifically, the particular materially false and misleading statements and/or omissions for which each defendant named in this Claim is charged with liability (and for which ICG would be charged but for its October 10, 2002 discharge from Chapter 11 bankruptcy) are as set forth in ¶¶ 148 to 166.

194. As set forth above in ¶¶ 35 to 137, ICG and Defendants Bryan and Beans employed devices, schemes, and artifices to defraud while in possession of material, adverse non-public information and engaged in the acts, practices, and a course of conduct that included the making of, or participation in the making of, untrue and misleading statements of material facts and omitting to state material facts necessary in order to make the statements about ICG not misleading. ICG and each defendant knew or, but for his recklessness would have known, that ICG's financial statements and announced financial results for which they are charged with liability in this Claim were materially overstated.

195. Defendants Bryan and Beans were among the senior officers of ICG, are liable for the false financial statements issued by ICG and for the other false public statements they and ICG made. Through their positions of control and authority as officers of ICG, Defendants were able to and did control the content of the public statements disseminated by ICG.

196. As a result of these deceptive practices and false and misleading statements and omissions, the market price of ICG common stock was artificially inflated during the Class Period. In ignorance of the false and misleading nature of the representations and omissions described above and the deceptive and manipulative devices employed by ICG and Defendants, Lead Plaintiffs and other members of the Class, in reliance on either the integrity of the market or directly on the statements and reports of ICG and Defendants Bryan and Beans, purchased ICG common stock at artificially inflated prices.

197. Had Lead Plaintiffs and other members of the Class known of the material adverse information not disclosed by Defendants, or been aware of the truth behind Defendants' material misstatements, they would not have purchased ICG common stock at artificially inflated prices.

198. The statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the false statements pleaded in this Second Consolidated and Amended Class Action Complaint. Not all of the specific statements pleaded herein were identified as "forward looking statements" when made. To the extent there were any forward-looking statements, there were no meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the purportedly forward-looking statements. Alternatively, to the extent that the statutory safe harbor does apply to any forward-looking statements pleaded herein, Defendants are liable for those false forward-looking statements when made because the particular speaker knew that the particular forward-looking statements were false, and/or the forward-looking statements were authorized and/or approved by an executive officer of ICG who knew that those statements were false when made.

199. By virtue of the foregoing, ICG and Defendants Bryan and Beans have violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

CLAIM II

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

200. Lead Plaintiffs repeat and reallege each of the allegations set forth in the foregoing paragraphs. This claim is brought pursuant to Section 20(a) of the Exchange Act on behalf of all purchasers of ICG common stock on the open market during the Class Period.

201. ICG is liable for violations of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. As set forth in ¶¶ 148 to 166, ICG knowingly made false and misleading statements to the public regarding its line counts and the amount of reciprocal compensation it expected to receive from RBOCs/ILECs. As set forth in ¶¶ 85 to 129 and ¶¶ 138 to 147, ICG acted with scienter because numerous employees of ICG knowingly falsified ICG's line counts and reciprocal compensation revenues in order for ICG to report these inflated results to the investing public.

202. Both Defendant Bryan and Defendant Beans was a controlling person of the Company within the meaning of Section 20(a) of the Exchange Act during the Class Period. Specifically, throughout the Class Period, each of the defendants had the power and authority to cause ICG to engage in the wrongful conduct complained of herein by reason of the following:

- a. Defendant Bryan had the power and authority to cause ICG to engage in the wrongful conduct complained of herein by virtue of his positions as

- Chairman of the Board and CEO of the Company, and through his substantial ownership of the Company's common stock outstanding; and
- b. Defendant Beans had the power and authority to cause ICG to engage in the wrongful conduct complained of herein by virtue of his positions as President and COO of the Company.

203. By reason of their positions of control over the Company, as alleged herein, each of the Defendants is liable jointly and severally with and to the same extent that ICG would be liable (but for its Chapter 11 bankruptcy filing and subsequent discharge) to Lead Plaintiffs and members of the Class as a result of the wrongful conduct alleged herein.

PRAYER FOR RELIEF

WHEREFORE, Lead Plaintiffs, on behalf of themselves and the other 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 Lead Plaintiffs to be proper Class representatives;
2. Awarding Lead Plaintiffs and the other members of the Class compensatory damages as a result of the wrongs alleged in the Complaint;
3. Awarding Lead 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. Awarding Lead Plaintiffs and the other members of the Class such other and further relief as the Court may deem just and proper.

JURY TRIAL DEMANDED

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

Dated: March 15, 2005

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