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WILLIAM H. WICKING
CLERK U.S. DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

8 UNITED STATES DISTRICT COURT
9 NORTHERN DISTRICT OF CALIFORNIA
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11 DONALD CHAN, On Behalf Of Himself And
All Others Similarly Situated,

Case No. **01 0595**

12 Plaintiff,

CLASS ACTION

13 vs.

**COMPLAINT FOR VIOLATION OF
THE FEDERAL SECURITIES LAW**

14 CRITICAL PATH, INC., WILLIAM H.
15 RINEHART, and DAVID A. THATCHER,

WHO

16 Defendants.
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JURY TRIAL DEMANDED

1 **SUMMARY OF THE ACTION**

2 1. This is a securities fraud class action on behalf of persons who purchased Critical
3 Path, Inc. ("Critical Path" or the "Company") common stock between November 2, 2000 through
4 February 1, 2001 (the "Class Period"), against Critical Path and its top officers for violation of
5 the federal securities laws arising out of defendants' dissemination of false and misleading
6 statements concerning the Company's business and its prospects for 2000 and beyond.

7 2. Critical Path provides e-mail hosting services to a variety of organizations,
8 including Internet service providers ("ISPs"), Web hosting companies, Web portals and
9 corporations. Many of these types of companies were new and were suffering from a downturn
10 in Internet-related funding which began in the spring of 2000. By September 2000 at the latest,
11 the problems many of these companies were having raising money had reached crisis levels.
12 Defendants had also known for months that new accounting regulations would negate the
13 Company's ability to continue to recognize up front license fees in Q4 2000. Defendants knew
14 this would severely impair Critical Path's future revenue growth and impair their ability to make
15 future stock sales and extract future bonuses which were tied to the Company's performance.
16 Thus, defendants continued to make positive but false statements about Critical Path's business
17 and future revenues during Q4 2000. As a result, Critical Path's stock traded as high as \$48.

18 3. On February 2, 2001, Critical Path issued a press release which stated in part:

19 Critical Path, Inc. announced today that the Board of Directors has formed
20 a special committee of the Board to conduct an investigation into the Company's
21 revenue recognition practices. The Company has discovered a number of
22 transactions that put into question the Company's financial results.

23 On January 18, 2001, the Company announced Fourth Quarter revenue of
24 \$52 million in revenue [sic] and net loss, excluding special charges, of \$11.5
25 million. The Company now believes that these results may be materially
26 misstated. The Company cautioned that the investigation has just begun.

27 Effective immediately, the Board of Directors has placed on administrative
28 leave David Thatcher, the Company's president, and William Rinehart, the vice
president of worldwide sales.

The special committee and the Company are working with its independent
auditors, PricewaterhouseCoopers, and outside counsel, Wilson Sonsini Goodrich
& Rosati.

This was directly contrary to what Critical Path's CEO had told shareholders and analysts just

1 weeks before.

2 4. This disclosure shocked the market, causing Critical Path's stock to decline to less
3 than \$4 per share in pre-market trading, inflicting hundreds of millions of dollars of damage on
4 plaintiff and the Class. Defendants' misconduct has wiped out over \$2 billion in market
5 capitalization as Critical Path stock has fallen 90% from its Class Period high of over \$48 per
6 share as the truth about Critical Path, its operations and prospects began to reach the market.

7 5. In response, analysts blasted the Company for its improper conduct. "This sounds
8 like it's out right fraud," said Charles Trafton, an Adams, Harkness and Hill analyst. "It sounds
9 like there was a concerted effort to cook the books."

10 **JURISDICTION AND VENUE**

11 6. The claims asserted herein arise under §§10(b) and 20(a) of the Securities
12 Exchange Act of 1934 ("1934 Act"), 15 U.S.C. §§78j(b) and 78t(a), and Rule 10b-5. Jurisdiction
13 is conferred by §27 of the 1934 Act, 15 U.S.C. §78aa.

14 7. Venue is proper here pursuant to §27 of the 1934 Act. Critical Path is located in
15 San Francisco, California and the acts and transactions giving rise to the violations of law
16 complained of occurred here.

17 **THE PARTIES**

18 8. Plaintiff Donald Chan purchased shares of Critical Path common stock as detailed
19 in the attached certification and was damaged thereby.

20 9. Defendant Critical Path is headquartered in San Francisco, with offices
21 worldwide. Critical Path provides the Internet messaging infrastructure upon which the new
22 economy is built. The Company is a single resource that powers the flow of mission-critical
23 information through an integrated portfolio of secure messaging, directory, data integration and
24 collaboration solutions. Critical Path's technology strengthens all aspects of the eBusiness value
25 chain by providing the messaging infrastructure that fuels customers' new and existing eBusiness
26 initiatives.

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1 were cutting capital expenditures which would cause Critical Path's future revenues to decline.
2 Moreover, defendants also had known for almost a year that new accounting rules would prevent
3 defendants from recognizing revenue from transactions defendants made merely on an up-front
4 licensor basis and could only be recognized on a "sell through" basis. Defendants actually knew
5 this would directly impact the Company's Q4.

6 16. Thus, at the time Critical Path reported its Q4 2000 results it faced increasingly
7 bleak short-term and long-term prospects. Nevertheless, defendants sought to conceal the
8 problems. Thus, defendants disseminated false information about Critical Path's business and
9 prospects concealing the fact that new accounting regulations would materially impact its Q4,
10 and its customers were cutting back on capital expenditures which would hurt future results.

11 17. Each of the defendants was personally familiar with Critical Path's Q4 2000
12 revenues as they monitored Critical Path's sales, closely monitoring the performance of Critical
13 Path's operations via reports from Critical Path's Finance and Sales Departments which were
14 generated and provided to management on a regular basis. The reports summarized orders,
15 dollar volume and product type. As a result of the Individual Defendants' monitoring, each of
16 the Individual Defendants was aware that Critical Path would be unable to meet its projected
17 results, as its ISP business was slowing and its customers were unable to continue the capital
18 expenditure programs at the levels previously conveyed to defendants in light of the dramatic
19 adverse developments of 2000. Moreover, defendants actually knew that the Company's ability
20 to recognize future revenue was contingent upon its ability to consummate a "sell through"
21 transaction. However, because the "appearance" of future growth was so critical to defendants'
22 plan to inflate the price of Critical Path shares, defendants continued to maintain throughout the
23 Class Period that Critical Path would post Q4 2000 revenue and EPS of at least \$55 million and
24 \$.01, respectively, when, in reality, defendants knew that Critical Path could not possibly achieve
25 such performance.

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1 **CLASS ACTION ALLEGATIONS**

2 18. This is a class action on behalf of purchasers of Critical Path common stock
3 between November 2, 2000 and February 1, 2001, excluding defendants (the "Class"). Excluded
4 from the Class are officers and directors of the Company, as well as their families and the
5 families of the defendants. Class members are so numerous that joinder of them is impracticable.

6 19. Common questions of law and fact predominate and include whether defendants:
7 (i) violated the 1934 Act; (ii) omitted and/or misrepresented material facts; (iii) knew or
8 recklessly disregarded that their statements were false; and (iv) artificially inflated Critical Path's
9 stock price and the extent of and appropriate measure of damages.

10 20. Plaintiff's claims are typical of those of the Class. Prosecution of individual
11 actions would create a risk of inconsistent adjudications. Plaintiff will adequately protect the
12 interests of the Class. A class action is superior to other available methods for the fair and
13 efficient adjudication of this controversy.

14 **FALSE AND MISLEADING STATEMENTS DURING THE CLASS PERIOD**

15 21. On November 2, 2000, Critical Path issued a press release entitled, "Critical Path
16 Provides Financial Guidance for Anticipated Fourth Quarter 2000 and Full Year 2001; Company
17 Capitalizes on Infrastructure Opportunity to Drive to Profitability and Join Elite Group of
18 Profitable New Economy Companies." The press release went on to state:

19 Critical Path, Inc. today provided financial guidance for the fourth quarter 2000
20 and the full year 2001, incorporating the expected contribution from the recent
21 acquisition of PeerLogic. This guidance, which was provided in New York City in
22 a meeting with over 100 investors and analysts, is intended to provide all investors
23 with information the Company believes is important in evaluating Critical Path's
24 business.

25 Citing the broad market opportunity, the Company expects revenue for the fourth
26 quarter ending December 31, 2000 of between \$54 million and \$56 million, which
27 represents growth of approximately 22 percent over the third quarter of 2000. The
28 Company expects pro forma earnings per share for the period to improve from a
loss of \$0.14 to a gain of approximately \$0.01 per share. For the year 2001,
revenue is expected to grow approximately 95 percent over 2000, to between \$300
million and \$310 million, with pro forma per share growing to a level ranging
between \$0.39 and \$0.41. These pro forma per share estimates exclude special
charges related to the amortization of goodwill and purchased technology,
acquisition-related retention bonuses and stock-based charges.

1 "The fourth quarter of 2000 is a pivotal one for Critical Path, one in which we join
2 an elite group of profitable 'new economy' companies. Critical Path is executing
3 across all product segments and target markets," said Doug Hickey, Critical Path's
4 CEO. "We anticipate continued high demand for our product and service
5 offerings, and leverage in our operations to deliver initial profitability in Q4 2000
6 and increase in our profitability in 2001."

7 22. After the close of the market on December 6, 2000, Critical Path issued a press
8 release entitled, "Critical Path Appoints New Chief Financial Officer; Lawrence P. Reinhold
9 Succeeds Mark Rubash, Former CFO; Company on Track to Deliver Profitability in Q4 and
10 2001." The press release stated in part:

11 Critical Path, Inc., the dominant global provider of business-to-business Internet
12 messaging infrastructure solutions, today announced that Lawrence P. Reinhold
13 will join the company as Executive Vice President and Chief Financial Officer.
14 Mark Rubash, the company's former CFO, has resigned for personal reasons
15 following a leave of absence due to family illness.

16 Reinhold brings almost 20 years of experience with technology companies'
17 finance operations to Critical Path from PricewaterhouseCoopers. With extensive
18 experience in accounting practices, public and private offerings, merger and
19 acquisitions, and managing company growth, Reinhold will add to Critical Path's
20 leadership bandwidth. Reinhold is the Managing Partner of PwC's Midwest
21 Region Technology, Information/Communications and Entertainment (TICE)
22 practice. He also serves on the leadership team for the entire U.S. TICE practice.

23 "We are extremely excited to have Larry join the Critical Path leadership
24 team. We selected Larry for three important criteria: experience managing growth
25 and expanding margins, hands on leadership, and fit within the CP team and the
26 dynamic market opportunity," said Doug Hickey, CEO of Critical Path. "In
27 addition to our executive team, we have a deep bench of experience in our finance
28 group and we're all committed to working with Larry through his pivotal quarter
of profitability and beyond. *We continue to be very bullish on both our short and
long term prospects.*"

"Critical Path is defining the market for Internet messaging infrastructure
solutions. It has an exciting and highly leverageable business model, a great
leadership position, and its accomplishments to date speak for the firm's quality of
execution," said Larry Reinhold. "Critical Path's messaging infrastructure
products and services continue to find high demand across geographies and
customer segments," continued Hickey. "Our business model and financial
controls are working, and we continue to eagerly anticipate Critical Path's turning
the corner to profitability in the fourth quarter." For specific financial guidance,
the company continues to refer investors to the previously stated guidance in a
press release of November 2, 2000.

"Mark has been a valuable asset to Critical Path during this year of
growth," continued Hickey. "As we emerge into the profitable phase, we will
build on the fruits of Mark's tenure. He contributed to the creation of a company
infrastructure that will scale to the next level of success. We thank him, and wish
him the best in his future endeavors."

1 23. Also on December 6, 2000, after the close of the market, Critical Path held a
2 conference call for analysts, money and portfolio managers, institutional investors and large
3 Critical Path shareholders to discuss Critical Path's Q4 results, its business and its prospects.
4 During the call - and in follow-up conversations with analysts - Doug Hickey stated:

- 5 • The Company would report a profitable Q4 of at least \$0.01 and revenue of
6 - \$55 million - its first profitable quarter ever;
- 7 • The Company's CFO was resigning for personal reasons - not associated
8 with any accounting problems with the Company;
- 9 • The Company's Q4 and fiscal 2001 prospects were extremely bullish;
- 10 • There would be no additional management changes in the near future; and
- 11 • The Company was not being impacted by foreign exchange fluctuation -
12 nor would it be - as the Company had a natural hedge against such risk as
13 its Euro-denominated expenses offset any Euro-denominated revenue hits.

14 24. After the close of the market on January 18, 2001, Critical Path issued a press
15 release entitled, "Critical Path Reports Fourth Quarter Revenue of \$52 Million; Company
16 Revises Guidance for 2001." The press release went on to state:

17 Critical Path, Inc., the dominant global provider of business-to-business Internet
18 messaging infrastructure solutions, today announced record financial results for
19 the quarter and year ended December 31, 2000.

20 Revenue for the quarter reached \$52.0 million, a 16 percent sequential
21 increase over revenue of \$45.0 million in the third quarter of 2000, and a 534
22 percent increase over revenue of \$8.2 million in the fourth quarter of 1999. The
23 net loss for the quarter, excluding special charges, was \$11.5 million, or \$0.16 per
24 share, compared with a net loss, excluding special charges, of \$8.7 million, or
25 \$0.14 per share, in the third quarter of 2000, and a net loss of \$11.0 million, or
26 \$0.26 per share, in the fourth quarter of 1999. The Company also reported gross
27 profit, excluding special charges, of \$29.1 million, a 15 percent increase over gross
28 profit of \$25.3 million in the third quarter of 2000.

29 The reported revenues for the quarter do not include \$7.0 million related to
30 a large enterprise license agreement that was executed during the quarter. Due to
31 complex and evolving rules governing revenue recognition for software license
32 arrangements, the Company, in consultation with its outside auditors, determined
33 that the revenue from this transaction required deferral as of December 31, 2000.
34 The Company anticipates recognizing the revenue from this transaction on a "sell-
35 through" basis in the future rather than as an up-front license fee in the fourth
36 quarter of 2000, as anticipated.

37 "Despite a difficult economic environment, Critical Path achieved solid
38 revenue growth and improved gross margins, while adding over 200 new
39 customers and further solidifying our category leadership position," said Doug
40 Hickey, Critical Path's CEO.

1 According to Chief Financial Officer Larry Reinhold, other factors in
2 addition to the deferred revenue mentioned previously had an impact on results in
3 the fourth quarter of 2000. These factors included a non-operating foreign
4 exchange loss due primarily to currency fluctuations in U.S. dollar-denominated
5 European revenues, higher than expected operating expenses in the recently
6 acquired PeerLogic business as full synergies have not yet been achieved, and the
7 provision of a significant allowance for doubtful accounts.

8 "While we are disappointed with the bottom-line impact of these charges,
9 we are evaluating and will be taking concrete steps to control the underlying
10 factors impacting these areas," said Reinhold.

11 Hickey stated, "Taking into account economic indicators that seem to be
12 affecting the technology sector across the board, we are also reevaluating our
13 guidance for 2001 and taking a very conservative stance toward the Company's
14 financial expectations. The Company expects revenue for the first quarter 2001 of
15 between \$54 million and \$56 million, and a loss per share, excluding special
16 charges, estimated between \$0.15 and \$0.16. For the full year 2001, revenue is
17 expected between \$255 million and \$260 million, with the Company becoming
18 profitable in the third quarter.

19 "It's disappointing to lower the expectations for Critical Path, but
20 macroeconomic forecasts and reports from leaders in the technology space lead us
21 to believe it is prudent to be conservative at this time," said Hickey. "It is our
22 strategy to make this move now and position the Company to execute effectively
23 throughout the year."

24 Hickey went on to discuss the positive indications for the quarter and the
25 year. "Regardless of near term uncertainty, I continue to be excited at the size and
26 potential of the Internet messaging solutions market, and my confidence is
27 bolstered by our success in addressing that market. We have the best and broadest
28 suite of messaging solutions, the most flexible delivery capability and the unique
ability to scale to meet the demands of the largest customers," he said.

Enterprise Customers

The Company has stated that penetrating the enterprise market is a major goal. During the quarter, Critical Path signed long-term contracts with more than 200 customers and partners. According to Hickey, approximately 62 percent of those contracts were with corporate enterprises, including Applied Materials, Wells Fargo, Farmers Insurance and Concentra Health.

"As enterprises continue to maximize the value of their IT resources and reduce costs, they are turning to Critical Path as the single organization uniquely positioned to help them reap value from their assets. Choosing our Internet messaging infrastructure solution solves a number of problems relating to cost, security and reliability, particularly for enterprises with widely distributed operations and offices," he said.

Messaging Reach and Scale

Critical Path has stated as its goal to "touch every user" on the Internet, with a messaging infrastructure that, through the Company's directory and meta-directory capabilities, scales to magnitudes unequalled in the industry. At the close of the quarter, Critical Path powered a total of approximately 178 million

1 mailboxes and wireless devices, including approximately 125 million licensed
2 boxes, 27 million outsourced email boxes, and 26 million wireless devices
worldwide.

3 "Our messaging infrastructure, including the directory products from
4 PeerLogic, delivers mega-scalability not only to large service providers and
5 enterprises, but also to major Internet business exchanges and many of the postal
6 services worldwide," said Hickey. "These customers are building their eBusiness
7 offering on our ability to manage tens of millions of messages and transactions
8 simultaneously in a secure environment. We are the only provider who can do
9 that, and only we are prepared to scale our customers to even greater capacity in
10 the future."

11 Wireless Partners and Services

12 Critical Path continued to make progress and achieve significant customer
13 wins in the emerging wireless sector. During the quarter, the Company announced
14 relationships with Logica for 2-way short messaging services, with Verizon to
15 hose email for its paging customers, and with SK Telecom, Korea's largest
16 wireless provider.

17 "Our strategy of offering a variety of services that support any wireless
18 protocol on any type of device presents us with a greater market opportunity than
19 is available to other providers," said Hickey.

20 International Business

21 Enabling international enterprises and service providers with Internet
22 messaging infrastructure solutions is intrinsic to Critical Path's strategy to "touch
23 every user" on the Internet. Hickey noted that approximately 33 percent of the
24 revenue in the fourth quarter came from international customers. "Because
25 Europe, Latin America and Asia are at an earlier stage of Internet adoption than
26 the U.S., there are tremendous opportunities to penetrate new markets," said
27 Hickey.

28 During the quarter, Critical Path announced contracts with ZipMail and
Diveo in Latin America, and BT CellNet in Europe.

Full Year Results

The Company reported revenue for 2000 of \$155.0 million, compared with
revenue of \$16.2 million in 1999. The net loss for the year, excluding special
charges, was \$57.2 million, or \$0.95 per share, compared with a net loss,
excluding special charges, of \$29.4 million, or \$0.99 per share, in 1999.

"Our balance sheet remains very strong and our financial resources are a
strategic advantage by which we can continue to pursue profitable business and
investment opportunities," said Hickey. The Company reported that as of
December 31, 2000, its cash and cash equivalents totaled \$216.5 million. During
the fourth quarter of 2000, the Company used \$25.9 million in cash.

1 25. Following the Company's January 18, 2001 Q4 announcement, Critical Path held
2 a conference call with analysts and large shareholders. During the conference call, defendants
3 stated:

4 Hickey: . . . In the fourth quarter, Critical Path saw strength across all lines of
5 business and we continued to see the validation of our strategy from all
6 major target markets, and those include Internet-centered wireless
7 telephone and enterprise market space. I will tell you that the CP sales
8 force executed well, bringing a major talent versus multiple services, and
9 our products continue to demonstrate their ability to achieve impressive
10 ROIs very quickly. Revenue reached about \$52 million, up 16 percent
11 sequentially from Q3. We are continually and repeatedly demonstrating
12 our products as the most complete and effective Internet messaging
13 infrastructure solutions available today and our customer list is evident of
14 that. This quarter we added some customers like Wells Fargo, Applied
15 Materials. Farmers Insurance, as well as a whole series of other
16 customers. We continued to see traction in our wireless relationships with
17 Verizon, Logica, with which we signed partnerships, and our customers
18 who we are partnered with is one that I think you'll agree is one of the best
19 in the category. Our gross profit, which includes a \$29.1 million, a 15
20 percent over gross profit in the third quarter of 2000. Now despite the fact
21 that net profitability has been pushed out, we continue to show meaningful
22 progress in that direction and the goal is within sight. Now on our balance
23 sheet we continue to remain very strong and our financial resources are a
24 strategic advantage but we shall continue to pursue profitable business and
25 investment opportunities. At the end of the quarter, cash and cash
26 equivalents equated to about \$216.5 million. Our operating results clearly
27 demonstrate, despite some unexpected events at Critical Path as well as a
28 tumultuous period of Internet-related industries, is trying to conquer
Internet messaging infrastructure solutions and customers across our four
broadly horizontal target markets are realizing the value they can reap
from turning to seeking customers seek solutions. Our results also solidify
our confidence that as our target customers seek solutions, we really stand
apart from the pack as a clear leader in the category with the best
[inaudible] of products and, by the way, the most flexible delivery
mechanisms. So, when you look at all that, you have to sit back and say,
"What really happened this quarter?" Suffice it to say, nothing we ever
want to see again. But let me first address the top line. As we begin to
close the book on the fourth quarter, to the best of our knowledge revenues
sit at about \$50 million. Late yesterday, our TWC team informed us of a
nuance they are reading into sales that indicated a \$7 million large
enterprise contract we executed during the quarter required deferral as of
December 31, 2000. We anticipate recognizing this revenue from the
transaction on a sale-free basis in the future rather than as if from a
licensee in the fourth quarter of 2000. This number increases our level of
deferred revenue but is of little comfort to any of us. We don't see this
ruling as an indication that CP's revenue model needs to be changed, nor
have we seen any lengthening in our sales cycle or a slow down in
demand. We have every reason to believe that this is a one-time
occurrence and you can believe we are working closely with TWC and our
team to eliminate the element of surprises going forward in this matter.
Next, what happened to keep us from achieving profitability? There are
really a couple of key factors there that held us back in this quarter.

1 Number one was a foreign exchange loss due to currency fluctuations in
2 dollar-denominated European revenues, and Larry will get into that in
3 detail. Secondly, there is a significant allowance in doubtful accounts
4 related to dot-com industry weakness which we took in the quarter. The
5 third factor affecting our profitability for the fourth quarter and affecting
6 our outlook for '01 is related to the ownership operating expenses at
7 PeerLogic which we acquired at the end of Q3, frankly, tells me we should
8 have been more conservative as we announced this highly strategic and
9 advantageous acquisition and assumed that the quality associated with it
10 would offset profitability out of the box. The other continues to drive
11 profitability in the long run as our lock on the megafield messaging market
12 was assured. After a quarter of integration efforts, our long-term outlook
13 on Peer Logic's contribution to our model is as strong as ever, and we
14 stand out as the only player in our category able to scale our functionalities
15 with the largest customers who are growing larger and larger every day.
16 For the time being, the synergies have not been fully realized but I can tell
17 you, you can be assured we'll have out stake in reducing operating
18 expenses in the future. These factors are not welcome, and I think that
19 goes without saying, in the quarter. In factual level we find totally
20 unacceptable and we single-mindedly focus on reversing this trend
21 immediately. Larry will talk to you about those efforts in a moment, but
22 in the meantime, I want to review up front changes to our financial
23 guidance that we decided to make in an effort to responsibly negate the
24 risk to shareholders as soon as we learned of changes in the operating
25 environment. As such, we are reducing expectations for revenue in Q1 of
26 2001 to between \$54 and \$56 million, and a loss this year, excluding
27 special charges, between 15 and 16 cents. For the full year 2001, revenue
28 is expected between \$255 and \$260 million, with the Company becoming
profitable in the third quarter of 2001 . . .

16 Larry:

16 Okay, thank you Doug, and I would like to thank each of you for joining
17 us today. As Doug stated, we are pleased with certain aspects of this
18 quarter's financial results and disappointed in others. Our opportunities
19 for the continued success we're having strategic focus. To avoid any
20 confusion, all of my comments today on our financial results exclude the
21 effect of special charges which are disclosed in our press release issued
22 earlier today. We are continuing to see strong demand for our licensed
23 and our hosted e-mail offerings, a greater degree of interest in our value
24 added services, and increased penetration into the corporate enterprise
25 market. Consistent with prior quarters, I would like to begin my remarks
26 by reviewing the quarterly operating results and our financial position and
27 our comments on the financial trends we are experiencing. As stated
28 earlier, net revenues for the quarter were \$52 million, up 16 percent
sequentially over the prior quarter, and that's an excess of 500 percent
over revenues of \$8.2 million in the fourth quarter of 1999. As outlined in
the press release and as mentioned previously, in addition to the \$52
million of revenue that we recorded, we also have entered into a \$7 million
software license arrangement during the quarter that we had anticipated
would be counted as revenue. However, due to very complex revenue
recognition rules that surround software transactions, we ended up
concluding that deferring all revenue from this transaction was
appropriate.

1 26. On February 2, 2001, Critical Path issued a press release entitled, "Critical Path
2 Forms Special Committee of the Board of Directors to Conduct Investigation Into Revenue
3 Recognition Issues; Two Officers Put On Administrative Leave." The press release stated, in
4 part:

5 Critical Path, Inc. announced today that the Board of Directors has formed
6 a special committee of the Board to conduct an investigation into the Company's
7 revenue recognition practices. The Company has discovered a number of
8 transaction that put into question the Company's financial results.

9 On January 18, 2001, the Company announced Fourth Quarter revenue of
10 \$52 million in revenue [sic] and net loss, excluding special charges, of \$11.5
11 million. The Company now believes that these results may be materially
12 misstated. The Company cautioned that the investigation has just begun.

13 Effective immediately, the Board of Directors has placed on administrative
14 leave David Thatcher, the Company's president, and William Rinehart, the vice
15 president of worldwide sales.

16 The special committee and the Company are working with its independent
17 auditors, PricewaterhouseCoopers, and outside counsel, Wilson Sonsini Goodrich
18 & Rosati.

19 27. This disclosure shocked the market, causing Critical Path's stock to decline to less
20 than \$4 per share in pre-market activity. Defendants' misconduct has wiped out over \$2 billion
21 in market capitalization as Critical Path stock has fallen 90% from its Class Period of over \$48
22 per share as the truth about Critical Path, its operations and prospects began to reach the market.

23 28. Each of the statements made by defendants between November 2, 2000 and
24 February 1, 2001 were false or misleading when issued. The true facts, which were known to
25 defendants, were:

26 a. Critical Path's revenue and EPS would fall materially short of meeting its
27 forecasted results as a result of newly implemented accounting regulations, which defendants had
28 known were going into affect and would impact its Q4 and would prevent it from recording not
only the projected \$55 in revenue but also the reported \$52 million of Q4;

b. Critical Path's reported Q4 results were materially false and misleading;

c. Critical Path's ability to meet even the projected results, including
profitability, was contingent upon its ability to improperly recognize revenue;

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1 d. Demand for Critical Path's products was not nearly as healthy as
2 represented due to the inability of much of Critical Path's customer base to pay for products; and
3 e. As a result of (a)-(d) above, it was impossible for defendants to achieve
4 Q4 revenue and EPS of \$55 million and \$0.01, respectively.

5 **DEFENDANTS' FALSE FINANCIAL STATEMENTS**

6 29. In order to inflate the price of Critical Path's stock, defendants caused the
7 Company to falsely report its results for at least Q4 2000 through improper revenue recognition.
8 Ultimately, Critical Path revealed that its results for the Q4 2000 might be materially misstated,
9 and that it was placing on leave its President and its Vice President of Worldwide Sales.

10 30. Critical Path reported the following results for the Q3 and Q4 2000:

	<u>9/30/00</u>	<u>12/31/00</u>
Total Revenue	\$45.0 M	\$52.0 M
Total Net Loss*	\$8.7 M	\$11.5M
Loss per Share*	\$0.14	\$0.16

15 * Excluding special charges

16 31. These Q3 results were included in a Form 10-Q filed with the SEC. The Q3 and
17 Q4 2000 results were included in press releases disseminated to the public.

18 32. Critical Path has now admitted that at least as to its Q4 2000 results, the financial
19 results may have been materially misstated such that they were not a fair presentation of Critical
20 Path's results and were presented in violation of Generally Accepted Accounting Principles
21 ("GAAP") and SEC rules.

22 33. GAAP are those principles recognized by the accounting profession as the
23 conventions, rules and procedures necessary to define accepted accounting practice at a particular
24 time. SEC Regulation S-X (17 C.F.R. §210.4-01(a)(1)) states that financial statements filed with
25 the SEC which are not prepared in compliance with GAAP are presumed to be misleading and
26 inaccurate, despite footnote or other disclosure. Regulation S-X requires that interim financial
27 statements must also comply with GAAP, with the exception that interim financial statements
28 need not include disclosure which would be duplicative of disclosures accompanying annual

1 financial statements. 17 C.F.R. §210.10-01(a).

2 34. Critical Path falsified its reported financial results through its improper revenue
3 recognition.

4 35. In Critical Path's 1999 Form 10-K, it represented the following with respect to its
5 revenue recognition on licenses:

6 Revenues for software licenses for which collection of the resulting
7 receivable is deemed probable are recognized upon delivery of the product
8 provided there is persuasive evidence of an arrangement, the fee is fixed and
9 determinable, and the agreement does not require significant customization of the
10 software. Revenues from software maintenance are recognized ratably over the
11 maintenance term. Revenues from the Company's enhanced facsimile, long
12 distance and other services are recognized as the services are performed. Amounts
13 billed or received in advance of service delivery are recorded as deferred revenue.

14 36. Pursuant to GAAP, as set forth in AICPA Statement of Position ("SOP") 97-2,
15 which describes the accounting for software licenses, revenue should not be recognized unless
16 there is persuasive evidence of an agreement, collection is probable and delivery has occurred.

17 37. During the Class Period, Critical Path improperly recognized revenue even though
18 these conditions did not exist.

19 38. Unfortunately for investors, these results, and the representations concerning
20 them, were false. Absent the Company's improper revenue recognition, Critical Path would have
21 reported materially lower revenues and higher losses in at least Q4 2000.

22 39. Ultimately, on February 2, 2001, Critical Path announced that its Q4 2000 results
23 "may be materially misstated" due to improper revenue recognition on a "number of
24 transactions."

25 40. Due to these accounting improprieties, the Company presented its financial results
26 and statements in a manner which violated GAAP, including the following fundamental
27 accounting principles:

28 a. The principle that interim financial reporting should be based upon the
same accounting principles and practices used to prepare annual financial statements was
violated (APB No. 28, ¶10);

//

1 b. The principle that financial reporting should provide information that is
2 useful to present and potential investors and creditors and other users in making rational
3 investment, credit and similar decisions was violated (FASB Statement of Concepts No.1, ¶34);

4 c. The principle that financial reporting should provide information about the
5 economic resources of an enterprise, the claims to those resources, and effects of transactions,
6 events and circumstances that change resources and claims to those resources was violated
7 (FASB Statement of Concepts No. 1, ¶40);

8 d. The principle that financial reporting should provide information about
9 how management of an enterprise has discharged its stewardship responsibility to owners
10 (stockholders) for the use of enterprise resources entrusted to it was violated. To the extent that
11 management offers securities of the enterprise to the public, it voluntarily accepts wider
12 responsibilities for accountability to prospective investors and to the public in general (FASB
13 Statement of Concepts No. 1, ¶50);

14 e. The principle that financial reporting should provide information about an
15 enterprise's financial performance during a period was violated. Investors and creditors often
16 use information about the past to help in assessing the prospects of an enterprise. Thus, although
17 investment and credit decisions reflect investors' expectations about future enterprise
18 performance, those expectations are commonly based at least partly on evaluations of past
19 enterprise performance (FASB Statement of Concepts No. 1, ¶42);

20 f. The principle that financial reporting should be reliable in that it represents
21 what it purports to represent was violated. That information should be reliable as well as
22 relevant is a notion that is central to accounting (FASB Statement of Concepts No. 2, ¶¶58-59);

23 g. The principle of completeness, which means that nothing is left out of the
24 information that may be necessary to insure that it validly represents underlying events and
25 conditions was violated (FASB Statement of Concepts No. 2, ¶79); and

26 h. The principle that conservatism be used as a prudent reaction to
27 uncertainty to try to ensure that uncertainties and risk inherent in business situations are
28 adequately considered was violated. The best way to avoid injury to investors is to try to ensure

1 that what is reported represents what it purports to represent (FASB Statement of Concepts No.
2 2, ¶¶95, 97).

3 41. Further, the undisclosed adverse information concealed by defendants during the
4 Class Period is the type of information which, because of SEC regulations, regulations of the
5 national stock exchanges and customary business practice, is expected by investors and securities
6 analysts to be disclosed and is known by corporate officials and their legal and financial advisors
7 to be the type of information which is expected to be and must be disclosed.

8 **CLAIM FOR RELIEF**

9 42. Defendants violated §10(b) and Rule 10b-5 by:

- 10 a. Employing devices, schemes and artifices to defraud;
- 11 b. Making untrue statements of material facts and omitting to state material
12 facts necessary in order to make the statements made, in light of the circumstances under which
13 they were made, not misleading; and
- 14 c. Engaging in acts, practices and a course of business that operated as a
15 fraud or deceit upon the Class in connection with their purchases of Critical Path stock.

16 43. Class members were damaged as they paid artificially inflated prices for Critical
17 Path common stock in reliance on the integrity of the market.

18 **PRAAYER**

19 WHEREFORE, plaintiff, on behalf of himself and the Class, prays for judgment as
20 follows:

- 21 A. Declaring this action to be a class action properly maintained pursuant to Rule 23
22 of the Federal Rules of Civil Procedure;
- 23 B. Awarding plaintiff and other members of the Class damages together with interest
24 thereon;
- 25 C. Awarding plaintiff and other members of the Class costs and expenses of this
26 litigation, including reasonable attorneys' fees, accountants' fees and experts' fees and other
27 costs and disbursements; and

28 //

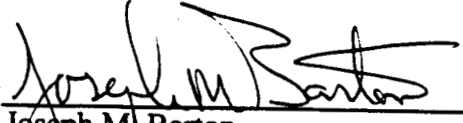
1 D. Awarding plaintiff and other members of the Class such equitable/injunctive or
2 other and further relief as may be just and proper under the circumstances.

3 **JURY DEMAND**

4 Plaintiff demands a trial by jury.

5 DATED: February 6, 2001

GOLD BENNETT CERA & SIDENER LLP

6
7 By: 
8 Joseph M. Barton

9 Attorneys for Plaintiff Donald Chan
and All Others Similarly Situated

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CERTIFICATION OF PLAINTIFF

I, Donald Chan, do hereby certify that:

I have reviewed the within complaint and authorize its filing by my attorneys, Gold Bennett Cera & Sidener LLP.

I did not purchase or otherwise acquire the common stock of Critical Path, Inc. that is the subject of the complaint at the direction of my counsel or in order to participate in any private action arising under the Securities Exchange Act of 1934 or the Securities Act of 1933, as amended by the Private Securities Litigation Reform Act of 1995.

I am willing to serve as representative party on behalf of a class, including providing testimony at deposition and trial, if necessary.

I made the following transactions during the class period in Critical Path, Inc. securities in the amounts and on the dates identified below and on the attached sheet:

Purchase / Sale	Transaction Date	Number of Shares	Price Per Share (\$)
Purchase	January 19, 2001	2,000	\$10.26

I have neither sought to serve nor served as a representative party on behalf of a class in any action brought under the federal securities laws that was filed during the three year period preceding the date of this certification.

I will not accept any payment for serving as a representative party on behalf of the Class beyond my pro rata share of any recovery, except such reasonable costs and expenses (including lost wages) directly relating to the representation of the Class and my activities in the lawsuit, as ordered or approved by the Court.

Nothing herein shall be construed to be or constitute a waiver of my attorney-client privilege.

I certify under penalty of perjury that the foregoing is true and correct.

Executed on February 6, 2001

Signed: 
Donald Chan

1 GOLD BENNETT CERA & SIDENER LLP
STEVEN O. SIDENER (State Bar No. 121062)
2 JOSEPH M. BARTON (State Bar No. 188441)
595 Market Street, Suite 2300
3 San Francisco, California 94105-2835
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5 Attorneys for Plaintiff Donald Chan
and All Others Similarly Situated
6
7

8 UNITED STATES DISTRICT COURT
9 NORTHERN DISTRICT OF CALIFORNIA

11 DONALD CHAN, On Behalf Of Himself And
All Others Similarly Situated,

12 Plaintiff,

13 vs.
14

15 CRITICAL PATH, INC., WILLIAM H.
RINEHART, and DAVID A. THATCHER,

16 Defendants.
17

Case No. C 01-0595-WHO

CLASS ACTION

**PROOF OF SERVICE PURSUANT TO
CIVIL L.R. 23-2**

18
19 I, Candy G. Windsor, hereby declare under penalty of perjury as follows:

20 I am employed by Gold Bennett Cera & Sidener LLP, 595 Market Street, Suite 2300,
21 San Francisco, CA 94105. I am over the age of eighteen years and am not a party to this action.

22 On February 7, 2001, in compliance with Civil L.R. 23-2 of the Local Rules of the United
23 States District Court for the Northern District of California. I served a hard copy of the
24 complaint Chan v. Critical Path, Inc., et al., Case No. C 01-0595-WHO, and a floppy diskette
25 containing an electronic version of the same, via regular mail and e-mail, to the entity listed
26 below:

27 //

28 //

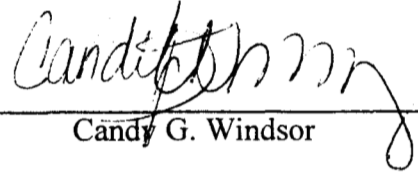
PROOF OF SERVICE PURSUANT TO CIVIL L.R. 23-2 - Case No. C 01-0595-WHO

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Securities Class Action Clearinghouse
Stanford Law School
Crown Quadrangle
Stanford, California 94305-8610

E-Mail: epost@securities.stanford.edu

Executed on February 7, 2001, at San Francisco, California.


Candy G. Windsor