UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

GRAYDON WILLIAMS, On Behalf of Himself and All Others Similarly Situated,	§	Civil Action No.
	§	CLASS ACTION
Plaintiff,	§	
	§	
vs.	§	
	§	
CORNELL COMPANIES, INC., STEPHEN W. LOGAN and JOHN L. HENDRIX,	§	
	§	
Defendants.	§	DEMAND FOR JURY TRIAL

COMPLAINT FOR VIOLATION OF THE FEDERAL SECURITIES LAWS

NATURE OF THE ACTION

1. This is a securities fraud class action on behalf of purchasers of the common stock of Cornell Companies, Inc. ("Cornell" or the "Company") between March 6, 2001 and March 5, 2002, inclusive (the "Class Period"), seeking to pursue remedies under the Securities Exchange Act of 1934 (the "Exchange Act"). Defendants are Cornell and certain of its officers and directors.

2. Cornell is a provider of privatized correctional, detention and pre-release services to governmental agencies. The Company provides integrated facility development, design, construction and operational services to government agencies within three operating divisions: adult secure institutional correctional and detention services; juvenile treatment, educational and detention services; and pre-release correctional and treatment services. During the Class Period, defendants issued favorable but false financial statements and made false and misleading statements about the Company's business. As a result of these false statements, the Company's stock traded as high as $18.40. Defendants took advantage of this artificial inflation, selling 3.4 million shares of Cornell stock for proceeds of over $48 million in a November 2001 secondary offering.

3. On February 6, 2002, the Company issued a press release entitled, "Cornell Reviews Sale/leaseback Transaction." The press release stated in part:

> Cornell Companies Inc. announced today a Special Committee of its Board of Directors has been formed to review the accounting for its August 2001 sale/leaseback transaction. The review is focused on a retainer agreement entered into with an investment bank ("Investment Bank") in September 2001, which provided (i) that Cornell pay the investment bank a non-refundable retainer fee of $3.65 million to provide financial advisory services concerning future financing vehicles and the strategic development of Cornell's business and (ii) that the retainer would be applied on a mutually agreed upon basis toward future contingent fees associated with investment banking services that may be provided to Cornell. The inquiry focuses on whether the retainer agreement affects the previously reported accounting treatment for the August 2001 sale/leaseback transaction, and whether the amount paid the Investment Bank was appropriately reflected in the Company's financial statements.
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> The sale/leaseback transaction involved a special purpose entity, Municipal Corrections Finance, L.P. ("MCF"), unaffiliated with Cornell and headquartered in Baton Rouge, La. The Investment Bank affiliates are the sole equity owners of the special purpose entity. The Special Committee is reviewing whether, as an accounting matter, the retainer amount paid by Cornell to the Investment Bank would reduce the previously established equity of the Investment Bank affiliate in the special purpose equity.

If equity were reduced below required levels, the effect would have material financial consequences, including requiring the consolidation of MCF's assets, liabilities and results of operations in Cornell's financial statements beginning in the 3rd quarter of 2001. In that event, Cornell's balance sheet would include the book value of the leased properties as an asset and the outstanding debt of MCF as a liability. Further, although consolidation would not have an effect on the Company's actual net cash flow, results of operations would be negatively impacted to the extent that interest on the MCF debt and depreciation on the facilities exceeded rental expense recorded by Cornell with respect to the leased facilities.

Cornell currently expects that the review of the accounting issues will be completed in conjunction with the audit of Cornell's financial statements for fiscal 2001. Cornell also believes that, if consolidation of MCF were required, it would only be required to continue any such consolidation until the Investment Bank restores the required equity level in MCF and that the Investment Bank would do so promptly upon notice to them that consolidation would be required. Any final determination in this regard would be subject to the concurrence of Cornell's independent auditors as well as the staff of the Securities and Exchange Commission, and continued compliance with the other applicable accounting requirements for non-consolidation of MCF.

The Special Committee, which is composed solely of independent directors, has retained independent counsel, who have also retained an independent accounting firm, to assist the Special Committee in its review. The Special Committee was formed in response to a letter dated Jan. 31, 2002, from Cornell's independent auditors to its Audit Committee which raised the issues that are the subject of the Special Committee's inquiry.

4. On February 6, 2002, *Bloomberg* ran an article on the Company which stated in part:

Cornell Cos., which operates 69 prisons in 13 states and the District of Columbia, said it will review the accounting of an August real estate transaction involving 11 properties. Its shares fell as much as 63 percent.

The company received a letter Thursday from auditor Arthur Andersen LLP that raised concern about the transaction, said Larry Stein of FRB Weber Shandwick, a firm that handles public relations for Cornell. The Andersen review was part of a year-end audit.

Cornell also named Harry Phillips chairman, replacing Steve Logan, who remains president and chief executive officer.

Cornell shares fell $6.72, or 38 percent, to $10.76 in midafternoon trading of 1.51 million shares, about 22 times the three-month daily average. They fell as low as $6.50.

The review is regarding a $3.5 million retainer fee paid in September to an unnamed investment banker for advising Cornell on the sale and leaseback of properties and for other banking services. Company officials declined to comment.

In August, Cornell said it sold 11 properties to Municipal Corrections Finance LP and subsequently leased them back, giving the Houston-based company $173 million to pay down debt. The initial lease term is 20 years and includes options to renew for another 25 years. Lehman Bros. handled the transaction.

* * *

Special Purpose Entity

"Instead of having debt on their balance sheet, right now they have an agreement with a special purpose entity which owns the equity," said analyst Linc Werden of HG Wellington & Co., who rates the company a "hold." "They still really have that debt."

Municipal Corrections Finance was created to acquire the properties and issued long-term investment-grade bonds rated "BBB" by Standard & Poor's to fund the purchase. In August, Cornell said in a statement the arrangement would save $1 billion over the term of the lease and said it was the first time "this advantageous structure has been accomplished in our industry."

5. Upon these disclosures, Cornell's stock dropped to as low as $6.50 before closing at $9.96 on February 6, 2002, some 45% below the Class Period high of $18.40.

6. On March 6, 2002, the Company issued a press release entitled,"Cornell Companies Inc. to Restate Its Financials for Year Ended December 31, 2000 and Subsequent Quarters." The press release stated in part:

-No earnings per share impact anticipated in 2000

-Diluted earnings per share impact of up to $0.06 anticipated in the first nine months of 2001

-No impact on current or future cash flow from consolidated accounting

Cornell Companies, Inc. today announced that as a result of the previously announced review by the Special Committee of the Board of Directors and after continued discussions with the Company's independent auditors, the Company has decided that it will restate its financial statements for the fiscal year ended Dec. 31, 2000 and its financial statements for each of the quarters ended March 31, 2001, June 30, 2001 and Sept. 30, 2001. The Special Committee, which is composed solely of independent directors, was formed to review the Company's accounting treatment for the August 2001 sale/leaseback transaction and, in the course of this review, also reviewed the accounting treatment for the Company's 2000 synthetic lease transaction. The restatement relates to the Company's review of the interpretation of complex accounting rules for the required equity investments in special purpose entities relevant to the Company's August 2001 sale/leaseback transaction and the Company's 2000 synthetic lease transaction.

Following discussions with its independent auditors and outside advisors, and in view of anticipated changes in accounting rules governing these types of transactions and the desire to reach a final resolution of these matters as quickly as possible, the Company has decided that both transactions will be consolidated for financial accounting purposes in the restated reports and for future periods.

Harry J. Phillips, Jr., the Company's chairman of the board, stated, "In today's market, we believe that the consolidated accounting treatment for the two transactions provides for greater transparency in our financial statements. Other than

an equipment sale/leaseback for approximately $10 million, we have no other off balance sheet arrangements. Importantly, the consolidated accounting will not impact our current or future cash flow. We believe that these announced actions will position the Company as an even stronger competitor in the corrections, treatment and educational industry."

The Company will file amended reports on Form 10-K/A for the fiscal year ended Dec. 31, 2000 and on Form 10-Q/A for each of the quarters ended March 31, 2001, June 30, 2001 and Sept. 30, 2001. The Company expects to file its restated reports with the SEC as soon as possible, but in no event later than the filing of the 2001 Form 10-K. Until restated results are released, financial statements for fiscal 2000 and the first three quarters of fiscal 2001, as well as the related Independent Auditors' Report for fiscal 2000, should not be relied upon. The Company's audit for the year ended Dec. 31, 2001 and the restated year ended Dec. 31, 2000 has not yet been completed. The Company currently intends to release the financial results for the year ended Dec. 31, 2001 and file its 2001 Form 10-K by March 29, 2002.

The consolidation of the assets and liabilities from the August 2001 sale/leaseback transaction onto the Company's financial statements is expected to have a non-cash reduction of up to $0.05 on diluted earnings per share for the nine months ended Sept. 30, 2001. In addition, this consolidation is expected to result in an increase in the combined total assets and liabilities of the Company by approximately $198 million and $199 million, respectively, as of Sept. 30, 2001.

The consolidation of the assets and liabilities from the 2000 synthetic lease transaction onto the Company's financial statements is expected to have no impact on earnings per share for 2000 and is expected to have a non-cash reduction of $0.01 diluted earnings per share for the nine months ended Sept. 30, 2001. In addition, this consolidation is expected to result in an increase in the combined total assets and liabilities of the Company by approximately $45 million as of Dec. 31, 2000 and by approximately $48 million as of Sept. 30, 2001.

The effect of the restatement of the financials will require waivers of certain covenants under the Company's senior credit facility since the covenants, as defined, presume the August 2001 sale/leaseback transaction. Based on discussions with its lenders, the Company expects to reach agreement to waive and/or restructure the covenants.

7. On this news, the Company's shares plummeted once again by more than 10%.

JURISDICTION AND VENUE

8. The claims asserted herein arise under and pursuant to §§10(b) and 20(a) of the Exchange Act [15 U.S.C. §§78j(b) and 78t(a)] and Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission ("SEC") [17 C.F.R. §240.10b-5].

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

10. Venue is proper in this District pursuant to §27 of the Exchange Act, and 28 U.S.C. §1391(b). Cornell maintains its principal place of business in this District and many of the acts and practices complained of herein occurred in substantial part in this District.

11. In connection with the acts alleged in this complaint, defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the mails, interstate telephone communications and the facilities of the national securities markets.

PARTIES

12. Plaintiff Graydon Williams purchased the common stock of Cornell at artificially inflated prices during the Class Period as detailed in the attached certification, and has been damaged thereby.

13. Defendant Cornell is a Delaware corporation with its principal place of business at 1700 West Loop South, Suite 1500, Houston, Texas 77027. Cornell is a provider of privatized correctional, detention and pre-release services to governmental agencies. The Company provides integrated facility development, design, construction and operational services to government agencies within three operating divisions: adult secure institutional correctional and detention services; juvenile treatment, educational and detention services; and pre-release correctional and treatment services.

14. Defendant Stephen W. Logan ("Logan") served at all time relevant hereto as CEO and President of the Company.

15. Defendant John L. Hendrix ("Hendrix") served at all time relevant hereto as CFO of the Company.

16. The defendants referenced above in ¶¶14-15 are referred to herein as the "Individual Defendants."

17. Because of the Individual Defendants' positions with the Company, they had access to the adverse undisclosed information about its business, operations, products, operational trends, financial statements, markets and present and future business prospects via access to internal corporate documents (including the Company's operating plans, budgets and forecasts and reports

of actual operations compared thereto), conversations and connections with other corporate officers and employees, attendance at management and Board of Directors meetings and committees thereof and via reports and other information provided to them in connection therewith.

18. It is appropriate to treat the Individual Defendants as a group for pleading purposes and to presume that the false, misleading and incomplete information conveyed in the Company's public filings, press releases and other publications as alleged herein are the collective actions of the narrowly defined group of defendants identified above. Each of the above officers of Cornell, by virtue of their high-level positions with the Company, directly participated in the management of the Company, was directly involved in the day-to-day operations of the Company at the highest levels and was privy to confidential proprietary information concerning the Company and its business, operations, products, growth, financial statements, and financial condition, as alleged herein. Said defendants were involved in drafting, producing, reviewing and/or disseminating the false and misleading statements and information alleged herein, were aware, or recklessly disregarded, that the false and misleading statements were being issued regarding the Company, and approved or ratified these statements, in violation of the federal securities laws.

19. As officers and controlling persons of a publicly held company whose common stock was, and is, registered with the SEC pursuant to the Exchange Act, and traded on the New York Stock Exchange (the "NYSE"), and governed by the provisions of the federal securities laws, the Individual Defendants each had a duty to disseminate promptly accurate and truthful information with respect to the Company's financial condition and performance, growth, operations, financial statements, business, products, markets, management, earnings, and present and future business prospects, and to correct any previously issued statements that had become materially misleading or untrue, so that the market price of the Company's publicly traded common stock would be based upon truthful and accurate information. The Individual Defendants' misrepresentations and omissions during the Class Period violated these specific requirements and obligations.

20. The Individual Defendants participated in the drafting, preparation, and/or approval of the various press releases, shareholder reports, SEC filings, and other communications complained of herein and were aware of, or recklessly disregarded, the misstatements contained

therein and omissions therefrom, and were aware of their materially false and misleading nature. Because of their Board membership and/or executive and managerial positions with Cornell, each of the Individual Defendants had access to the adverse undisclosed information about Cornell's business, prospects, and financial condition as particularized herein and knew (or recklessly disregarded) that these adverse facts rendered the positive representations made by or about Cornell and its business issued or adopted by the Company materially false and misleading.

21. The Individual Defendants, because of their positions of control and authority as officers and/or directors of the Company, were able to and did control the content of the various SEC filings, press releases and other public statements pertaining to the Company during the Class Period. Each Individual Defendant was provided with copies of the documents alleged herein to be misleading prior to or shortly after their issuance and/or had the ability and/or opportunity to prevent their issuance or cause them to be corrected. Accordingly, each of the Individual Defendants is responsible for the accuracy of the public reports and releases detailed herein and is therefore primarily liable for the representations contained therein.

22. Each of the defendants is liable as a participant in a fraudulent scheme and course of business that operated as a fraud or deceit on purchasers of Cornell common stock by disseminating materially false and misleading statements and/or concealing material adverse facts. The scheme: (i) deceived the investing public regarding Cornell's business, operations, management and the intrinsic value of Cornell common stock; (ii) enabled Cornell to remain in compliance with its senior credit facility covenants; and (iii) enabled Cornell to sell 3.45 million shares of its common stock at $14 per share in a November 2001 secondary offering pursuant to a Prospectus Supplement dated November 27, 2001 for proceeds of $48.3 million.

PLAINTIFF'S CLASS ACTION ALLEGATIONS

23. Plaintiff brings this action as a class action pursuant to Federal Rule of Civil Procedure 23(a) and (b)(3) on behalf of a Class consisting of purchasers of Cornell common stock during the Class Period and who were damaged thereby (the "Class"). Excluded from the Class are defendants, the officers and directors of the Company, members of their immediate families and

their legal representatives, heirs, successors or assigns and any entity in which defendants have or had a controlling interest.

24. The members of the Class are so numerous that joinder of all members is impracticable. Throughout the Class Period, Cornell's common stock was actively traded on the NYSE. While the exact number of Class members is unknown to plaintiff at this time and can only be ascertained through appropriate discovery, plaintiff believes that there are thousands of members in the proposed Class. Record owners and other members of the Class may be identified from records maintained by Cornell or its transfer agent and may be notified of the pendency of this action by mail, using the form of notice similar to that customarily used in securities class actions.

25. Plaintiff's claims are typical of the claims of the members of the Class as all members of the Class are similarly affected by defendants' wrongful conduct in violation of federal law that is complained of herein.

26. Plaintiff will fairly and adequately protect the interests of the members of the Class and has retained counsel competent and experienced in class and securities litigation.

27. 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 as alleged herein;

(b) whether statements made by defendants to the investing public during the Class Period misrepresented material facts about the business, operations and management of Cornell; and

(c) to what extent the members of the Class have sustained damages and the proper measure of damages.

28. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy since joinder of all members is impracticable. Furthermore, as the damages suffered by individual Class members may be relatively small, the expense and burden of

individual litigation make it impossible for members of the Class to individually redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

BACKGROUND AND OVERVIEW

29. Cornell is a provider of privatized correctional, detention and pre-release services to governmental agencies. The Company provides integrated facility development, design, construction and operational services to government agencies within three operating divisions: adult secure institutional correctional and detention services; juvenile treatment, educational and detention services; and pre-release correctional and treatment services.

30. During the Class Period, defendants issued materially false and misleading statements concerning Cornell's financial results. During the Class Period, before the disclosure of the true facts, the Individual Defendants caused Cornell to sell 3.45 million shares of its common stock generating more than $48 million in proceeds.

MATERIALLY FALSE AND MISLEADING STATEMENTS ISSUED DURING THE CLASS PERIOD

31. On March 6, 2001, Cornell reported its year end and fourth quarter 2000 results in a press release which stated in part:

> – 2000 income from operations rose 31%, as revenues increased 28% vs.1999.
>
> – 2000 diluted EPS were $0.84 vs. $0.86 in 1999 (before accounting change in 1999), as stronger operating results were reduced by higher interest costs.
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> – Q4 2000 diluted EPS were $0.20, meeting the Company's previously announced expectations. Fourth Quarter and Year's Highlights (Amounts in thousands, except per share data and percentages).
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> * * *
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> "Cornell's revenue grew 28% and income from operations increased 31% for the year. While higher interest costs reduced earnings per share, we used the funds to penetrate additional, highly strategic markets with the acquisition of Interventions in the fourth quarter of 1999, a leader in treatment programs, and to expand our D. Ray James facility and our Big Spring complex. Looking ahead, we expect the acquisition and expansions to significantly increase revenues, and this, combined with new programs and margin improvement initiatives, is anticipated to drive higher profitability into the latter half of 2001, with expectations of approximately $0.90 in diluted EPS for the full year."
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> – Steve W. Logan, President and Chief Executive Officer of Cornell Companies

Cornell Companies, Inc. today reported that income from operations for the year ended December 31, 2000, rose 31% to $29.1 million on revenues of $226.1 million. Net income for the year ended December 31, 2000, was $8.0 million or $0.84 per diluted share, compared with $8.3 million or $0.86 per diluted share in 1999, before cumulative effect of change in accounting principle in 1999. Earnings per share decreased 2% versus 1999 primarily due to higher interest expense.

The revenue growth in 2000 was driven by the acquisition of Chicago-based Interventions in the fourth quarter of 1999, various facility expansions including the D. Ray James Prison in Georgia and the Big Spring Complex in Texas, and the continued increase in new non-residential treatment programs. The increase in interest expense arose from the 100 basis-point increase in interest rates in 2000 and the Company's increased indebtedness, which resulted from its penetration into new markets with its acquisition of Interventions and its expansion at the D. Ray James Prison and the Big Spring Complex. While the activation of new programs and facility expansions will initially result in additional start-up costs, the Company expects the acquisitions and expansions in 2000 to begin to have a positive impact on results in the second half of 2001.

Quarterly Results

The Company's revenues for the fourth quarter of 2000 increased 22% to a record $60.4 million and income from operations was $7.2 million compared to $7.5 million in 1999. Net income for the fourth quarter of 2000 was $1.9 million or $0.20 per diluted share (meeting the Company's expectations), compared with $2.8 million, or $0.29 per diluted share for the 1999 period. Interest expense for the fourth quarter of 2000 was $4.0 million versus $2.8 million for the same period in 1999. Fourth quarter of 2000's results include approximately $0.01 per share in pre-opening and start-up costs for the initial ramp-up of new operations at the Company's New Morgan Academy.

Steve W. Logan, President and Chief Executive Officer, stated, "Cornell's revenue grew 28% and income from operations increased 31% for the year. While higher interest costs reduced earnings per share, we used the funds to penetrate additional, highly strategic markets with the acquisition of Interventions in the fourth quarter of 1999, a leader in treatment programs, and to expand our D. Ray James facility and our Big Spring complex. Fourth quarter of 2000's results include approximately $0.01 in after-tax EPS in pre-opening and start-up costs for the initial ramp-up of operations at our New Morgan Academy. Consistent with the start-up of any new significant program, we expect these start-up costs to increase while we ramp-up the occupancy at the New Morgan Academy and other new programs through the second quarter of 2001, with greater returns expected through the latter half of the year."

Logan added, "This future increase in occupancy, along with other recently added new programs and margin improvement initiatives, is expected to drive increasing profitability into the latter half of 2001. In addition to increasing our growth in non-capital, treatment programs, we will continue to pursue the previously discussed facility sale/leaseback to de-lever our balance sheet and to facilitate funding new project awards and potential acquisitions."

32. On May 8, 2001, Cornell reported first quarter 2001 results in a press release which stated in part:

– First quarter 2001 diluted EPS was $0.09, exceeding analysts' estimates and the Company's guidance of approximately $0.07.

– First quarter 2001 revenues of $60.6 million reflect a 13% increase over Q1 2000.

– First quarter 2001 diluted EPS of $0.09 vs. $0.21 in Q1 2000 reflects increased start-up costs from new contract awards and previously reported cost increases that are expected to be recouped on a going forward basis after mid-year per-diem increases.

– Management reconfirms the estimate of annual 2001 diluted earnings per share of approximately $0.90.

* * *

"The strength of certain of our core facilities enabled the Company to exceed analysts' earnings estimates and previous Company guidance for the quarter. Consistent with the ramp-up of new programs and facilities, our first quarter results reflect the additional pre-opening and start-up costs associated with new contract awards and facility expansions. While these temporary start-up costs combined with the previously announced increases in labor, medical and utility costs that we began to experience last year resulted in a reduction in our quarterly earnings, we expect our investments in the New Morgan Academy, and the ACAF and Big Spring complex expansions to add significantly to our profitability during the last half of 2001, as these new facilities and expansions emerge from the start-up phase. In addition, we expect to recoup, on a going forward basis, the majority of these labor and other cost increases through contractual CPI increases that typically take effect mid-year and other negotiated revenue rate increases. We continue to see increasing demand in the diversified corrections and treatment market and continue to expect to report full year 2001 diluted earnings per share of approximately $0.90."

– Steve W. Logan, President and Chief Executive Officer of Cornell Companies

Cornell Companies Reports First Quarter 2001 Results; Q1 2001 EPS Exceeds Analysts' Estimates and Company Guidance

Cornell Companies, Inc. today reported net income for the quarter ended March 31, 2001, of $824,000 or $0.09 per diluted share after the cumulative effect of change in accounting principle, compared with $2.0 million or $0.21 per diluted share in the first quarter of 2000. Reported Q1 2001 earnings per share exceeded the previously announced estimate of approximately $0.07. The decrease in earnings per share versus Q1 2000 primarily reflects increased start-up costs associated with new contract awards and programs, one less day in the quarter, and previously announced increases in operating costs, such as, utilities, labor, and medical, and increases in general and administrative costs. The majority of these operating cost increases are expected to be recouped on a going forward basis due to contractual and expected mid-year per-diem revenue rate increases. Management reaffirmed its previously announced estimate of annual 2001 diluted earnings per share of approximately $0.90.

The first quarter of 2001's results include approximately $0.06 per share in net pre-opening and start-up costs from the ramp-up of operations at the Company's New Morgan Academy and the expansion of its ACAF facility. One less calendar day of revenue during the current quarter resulted in an approximately $0.02 per share decrease in earnings vs. the first quarter in the previous year. Higher seasonal

utility rate increases resulted in approximately $0.03 per share decrease in earnings from the comparable quarter. Other previously announced cost increases that are expected to be recouped on a going forward basis after mid-year and other contractual per-diem revenue rate increases include higher personnel retention costs and higher medical costs at certain facilities. These extra costs for the quarter were approximately $0.09 per share for the quarter vs. the same quarter in the previous year. The above cost differences comprise approximately $0.20 per share for Q1 2001.

* * *

Outlook

Looking toward the second quarter of 2001, Logan commented, "The Company expects to see profitability significantly increase in Q2 as the New Morgan Academy begins to ramp-up out of the start-up phase, and as the seasonally higher utility costs begin to reduce after the first quarter. In addition, the second quarter will benefit from already received increases in certain per-diem revenue rates which, when combined with the above profit increases, is expected to result in diluted earnings per share of approximately $0.18 for the second quarter. Our estimated annual 2001 EPS of approximately $0.90 reflects the expected strength in the latter part of 2001 as our new contract awards and facility expansions ramp-up in occupancy and we receive our contractual mid-year per diem and other negotiated revenue rate increases. In addition to increasing our growth in non-capital, treatment programs, we continue to make significant progress toward the potential facility sale/leaseback to de-lever our balance sheet and to facilitate funding new project awards and potential acquisitions. There is potential future EPS accretion which could result if the facility sale/leaseback transaction is consummated."

33. On August 15, 2001, Cornell reported better than expected second quarter 2001 results and the closing of a sale/leaseback transaction, in a press release which stated in part:

Sale/Leaseback Transaction Enhances Company's Position For Future Growth

– Second quarter 2001 diluted EPS was $0.22, exceeding analysts' estimates of $0.18.

– In a separate release earlier today, the Company also announced the closing of a sale/leaseback transaction led by Lehman Brothers which yielded approximately $173 million in proceeds to the Company, creating a vehicle for future growth and having industry-changing potential.

– The sale/leaseback transaction enhances the Company's position for future growth.

– Second quarter 2001 revenues of $65.7 million reflect a 19% increase over Q2 2000.

– The increase in the second quarter earnings per share over analysts' estimates was due to receiving certain per diem increases sooner than expected and continuing efforts to implement productivity improvements.

– Management confirms its estimates of annual 2001 diluted earnings per share of approximately $0.90 prior to financing and other special charges.

– Third quarter diluted earnings per share are expected to be approximately $0.30 prior to financing and other special charges.

* * *

"We are pleased to announce strong second quarter EPS that exceeded estimates by 22%. In a separate release, also issued today, the Company announced the closing of a sale/leaseback transaction, which was led by Lehman Brothers. The Buyer purchased 11 of our properties, yielding significant cash proceeds to the Company. The facilities will be leased back for an initial period of 20 years at attractive, fixed rents, with approximately 25 years of additional renewal period options. While this transaction provides significant cash proceeds to the Company, the most important point is it provides an attractive vehicle for potential future facility purchases. This transaction, along with being able to report earnings that exceeded analysts' estimates, demonstrates the strength of our Company and industry in a slowing economy. We expect to report full year diluted earnings per share of approximately $0.90 prior to financing and other special charges."

Steven W. Logan, Chairman of the Board of Directors and Chief Executive Officer of Cornell Companies

Cornell Companies, Inc. today reported net income for the quarter ended June 30, 2001, of $2.1 million or $0.22 per diluted share compared with $2.2 million or $0.23 per diluted share in the second quarter of 2000. Reported Q2 2001 earnings per share exceeded analysts' estimate of $0.18 by 22 percent. In a separate release, the Company also announced the closing of a facility sale/leaseback transaction led by Lehman Brothers, which provided the Company with approximately $173 million in proceeds. One of the many benefits of the sale/leaseback's structure is its "open-ended" ability to purchase additional properties in the future from the Company.

The increase in the second quarter earnings per share over analysts' estimates was due to receiving certain per diem increases sooner than expected and the Company's continuing efforts to implement productivity improvements.

* * *

Outlook

Looking at the third quarter of 2001, Logan commented, "The Company expects to see increases in profitability in Q3. As expected, our New Morgan Academy's occupancy has ramped up out of its start-up phase and is beginning to contribute to the Company's profitability. This, along with increases in certain per-diem revenue rates and our continuing efforts to implement productivity improvements, has resulted in the higher than expected earnings per share for the second quarter. Our earnings run-rate should continue to benefit in the last half of the year from the continued increase in occupancy expected at New Morgan and other expansions, the activation of newly awarded take-or-pay contracts, and negotiated mid-year revenue rate increases. In addition, our recent withdrawal of our re-bid proposal for the under-performing Santa Fe County Detention Center is expected to be accretive to future earnings. These items are expected to result in diluted earnings per share of approximately $0.30 for the third quarter, prior to financing and other special charges. Our operational diversity continues to provide a broader field of development opportunities as we see increasing demand throughout the diversified corrections and treatment markets. We expect to report

full year 2001 diluted earnings per share of approximately $0.90 prior to financing and other special charges."

34. On October 30, 2001, Cornell reported a 50% increase in third quarter 2001 EPS, excluding extraordinary and unusual charges, in a press release which stated in part:

> – Revenues rose 21% to $68.7 million, driven by per-diem rate increases and a facility ramp-up.
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> – Income from operations decreased 2% to $7.3 million, excluding unusual charges, primarily reflecting the reclassification of facility cost resulting from the previously reported sale/leaseback refinancing.
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> – Earnings also benefitted from lower interest expense, resulting from reduced debt levels associated with the sale/leaseback and lower rates.
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> * Q3 2001 extraordinary and unusual charges totaled $0.15 per share:
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> – $0.10 per share of financing charges due to the early retirement of debt using proceeds from the sale/leaseback refinancing; and
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> – $0.05 per share write-off of development and closing charges.
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> * Management confirms $0.90 estimate of annual 2001 diluted EPS prior to unusual charges.
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> * * *
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> "Cornell's 50% increase in comparable quarter -over- quarter EPS reflects 21% growth in revenues and higher profitability. Fortunately, our operations were not materially affected by the tragic events of September 11, and we continue to build growth and profitability with the opening of new facilities and the implementation of profit improvement initiatives. For the year 2001, we still expect to report diluted earnings per share of approximately $0.90 prior to extraordinary and unusual charges. As we approach 2002, the outlook for further progress is very encouraging."
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> – Steve W. Logan, Chairman and Chief Executive Officer of Cornell Companies ...
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> ... Cornell Companies, Inc. today reported diluted earnings per share of $0.30 prior to extraordinary and unusual charges, a 50% increase from the comparable $0.20 per diluted share in the third quarter of 2000. The extraordinary and unusual items represented non-cash charges during the current quarter. The earnings prior to the expected unusual charges met Company and analysts' estimates. Actual reported diluted earnings of $0.15 per share reflect $0.15 per diluted share of extraordinary and unusual charges consisting of: (1) financing charges of $0.10 per share due to the early retirement of debt using proceeds from the previously reported sale/leaseback refinancing; and (2) the write-off of development and closing charges of $0.05 per share. Even if net start-up costs of approximately $.02 per share are added back for the third quarter of 2000, the Company still achieved a 36% increase in comparable quarter-over-quarter earnings per share.
>
> Revenues increased 21% to a record $68.7 million from $56.7 million reported in the third quarter 2000. The increase in third quarter revenues was due to

> per-diem rate increases realized in 2001, the continued ramp-up of the New Morgan Academy which began operations late in the fourth quarter of 2000, and the benefit of additional new contracts and expansions. In addition, Cornell's focus on low-capital intensive services led to the third quarter opening of new treatment and education facilities in Alexander, Arkansas and Harrisburg, Pennsylvania.
>
> Third quarter 2001 income from operations was $7.3 million compared with $7.5 million in the year-ago period, excluding unusual charges totaling $923,000 related to the write-off of development and closing charges noted above. Operating margin increased from the first half of the year, driven mainly by the ramp-up of the New Morgan Academy facility from its start-up phase to solid profitability and the recoupment of costs through per diem revenue increases. Cornell's selective withdrawal from under-performing contracts and the continued implementation of productivity improvement measures also contributed to higher profitability. Earnings further benefitted from lower interest expense compared with last year's third quarter, which resulted from lower debt levels and interest rates.
>
> * * *
>
> Logan continued, "Consistent with our previous guidance, we realized significant quarter-over-quarter earnings growth in the third quarter and expect substantial quarter-over-quarter growth again in the fourth quarter of 2001, before any extraordinary charges. This earnings growth, combined with the retirement of our senior debt and the additional financing platform provided by our sale leaseback structure, creates a more solid foundation for future earnings visibility. We remain committed to enhancing our capital structure to capitalize on the many opportunities we see developing."

35. On October 30, 2001, the Company filed a Form 10-Q with the SEC which included Cornell's results for the third quarter of 2001. The Form 10-Q represented that Cornell had operating income of $6.4 million and EPS of $0.15 in the third quarter, total assets of $185.7 million, long term debt of $38.4 million and stockholder equity of $109.2 million at September 30, 2001. The Form 10-Q also stated in part:

> The accompanying unaudited consolidated financial statements have been prepared by Cornell Companies, Inc. (the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, all adjustments and disclosures necessary for a fair presentation of these financial statements have been included.

36. In fact, the Company's results and financial statements were false and misleading and prepared in violation of Generally Accepted Accounting Principles ("GAAP"), as described in ¶¶43-60, due to its failure to consolidate a non-qualifying Special Purpose Equity ("SPE"). The 10-Q was signed by defendants Logan and Hendrix.

37. On December 3, 2001, the Company issued a press release entitled, "Cornell Companies Raises $48.3 Million Through the Successful Sale of 3,450,000 Shares of Common Stock." The press release stated in part:

> The transaction, which included the sale of an over-allotment of 450,000 shares, eliminates all of Cornell's balance sheet debt and leaves approximately $50 million of cash, creating a stronger position to capitalize on opportunities for expansion. The successful follow-on offering, lead-managed by Lehman Brothers, adds to the visibility of the company through the additional analyst coverage by Lehman and Jefferies.
>
> Cornell Companies today announced it raised $48.3 million through the successful sale of 3,000,000 shares of common stock and a fully subscribed over-allotment of 450,000 shares. The proceeds from this transaction will be used in part to retire the company's subordinated notes, resulting in a balance sheet with virtually no long-term debt. Combined with the previously announced sale/leaseback transaction, the company is now in a strengthened position to further expand its operations. Presently, there are a number of projects coming up for bid in the corrections industry and Cornell will be well positioned to capitalize on these opportunities. The offering was lead-managed by Lehman Brothers and co-managed by Jefferies & Company Inc. and First Analysis Securities Corporation.
>
> Since the proceeds of the sale will be used, in part, to retire the Company's 12.875% subordinated notes, the immediate impact from the sale of 3,000,000 shares is non-dilutive. However, the sale of the additional 450,000 shares to cover the underwriters' over-allotment results in a dilution of approximately three cents per diluted share. The Company will now have approximately $50 million in cash and virtually no long-term debt on its balance sheet.
>
> Steven W. Logan, chairman and CEO, said, "The successful completion of this public equity offering marks an exciting time for our company. This infusion of equity capital provides additional 'dry powder,' greatly enhancing Cornell's financial liquidity and capacity at a time when numerous potentially accretive projects are being presented to our industry. We believe this offering, combined with our previously announced sale/leaseback transaction, provides the company with a competitive edge and a strong platform for expansion."
>
> Logan continued, "We are very pleased with the strong reception that we received from the public equity markets and with the addition of top-tier analyst coverage by both Lehman and Jefferies. Given our financial strength and operational excellence, as well as the opportunities building in the marketplace, we believe Cornell is positioned for significant long-term progress."

38. In connection with the Secondary Offering, the Company filed a Registration Statement/Prospectus which incorporated the Company's third quarter results.

39. On February 6, 2002, the Company issued a press release entitled, "Cornell Reviews Sale/leaseback Transaction." The press release stated in part:

> Cornell Companies Inc. announced today a Special Committee of its Board of Directors has been formed to review the accounting for its August 2001

sale/leaseback transaction. The review is focused on a retainer agreement entered into with an investment bank ("Investment Bank") in September 2001, which provided (i) that Cornell pay the investment bank a non-refundable retainer fee of $3.65 million to provide financial advisory services concerning future financing vehicles and the strategic development of Cornell's business and (ii) that the retainer would be applied on a mutually agreed upon basis toward future contingent fees associated with investment banking services that may be provided to Cornell. The inquiry focuses on whether the retainer agreement affects the previously reported accounting treatment for the August 2001 sale/leaseback transaction, and whether the amount paid the Investment Bank was appropriately reflected in the Company's financial statements.

The sale/leaseback transaction involved a special purpose entity, Municipal Corrections Finance, L.P. ("MCF"), unaffiliated with Cornell and headquartered in Baton Rouge, La. The Investment Bank affiliates are the sole equity owners of the special purpose entity. The Special Committee is reviewing whether, as an accounting matter, the retainer amount paid by Cornell to the Investment Bank would reduce the previously established equity of the Investment Bank affiliate in the special purpose equity.

If equity were reduced below required levels, the effect would have material financial consequences, including requiring the consolidation of MCF's assets, liabilities and results of operations in Cornell's financial statements beginning in the 3rd quarter of 2001. In that event, Cornell's balance sheet would include the book value of the leased properties as an asset and the outstanding debt of MCF as a liability. Further, although consolidation would not have an effect on the Company's actual net cash flow, results of operations would be negatively impacted to the extent that interest on the MCF debt and depreciation on the facilities exceeded rental expense recorded by Cornell with respect to the leased facilities.

Cornell currently expects that the review of the accounting issues will be completed in conjunction with the audit of Cornell's financial statements for fiscal 2001. Cornell also believes that, if consolidation of MCF were required, it would only be required to continue any such consolidation until the Investment Bank restores the required equity level in MCF and that the Investment Bank would do so promptly upon notice to them that consolidation would be required. Any final determination in this regard would be subject to the concurrence of Cornell's independent auditors as well as the staff of the Securities and Exchange Commission, and continued compliance with the other applicable accounting requirements for non-consolidation of MCF.

The Special Committee, which is composed solely of independent directors, has retained independent counsel, who have also retained an independent accounting firm, to assist the Special Committee in its review. The Special Committee was formed in response to a letter dated Jan. 31, 2002, from Cornell's independent auditors to its Audit Committee which raised the issues that are the subject of the Special Committee's inquiry.

40. Upon these disclosures, Cornell's stock declined to as low as $6.50 before closing at $9.96, on February 6, 2002, some 45% below the Class Period high of $18.40.

41. On March 6, 2002, the Company issued a press release entitled,"Cornell Companies Inc. to Restate Its Financials for Year Ended December 31, 2000 and Subsequent Quarters." The press release stated in part:

> -No earnings per share impact anticipated in 2000
>
> -Diluted earnings per share impact of up to $0.06 anticipated in the first nine months of 2001
>
> -No impact on current or future cash flow from consolidated accounting
>
> Cornell Companies, Inc. today announced that as a result of the previously announced review by the Special Committee of the Board of Directors and after continued discussions with the Company's independent auditors, the Company has decided that it will restate its financial statements for the fiscal year ended Dec. 31, 2000 and its financial statements for each of the quarters ended March 31, 2001, June 30, 2001 and Sept. 30, 2001. The Special Committee, which is composed solely of independent directors, was formed to review the Company's accounting treatment for the August 2001 sale/leaseback transaction and, in the course of this review, also reviewed the accounting treatment for the Company's 2000 synthetic lease transaction. The restatement relates to the Company's review of the interpretation of complex accounting rules for the required equity investments in special purpose entities relevant to the Company's August 2001 sale/leaseback transaction and the Company's 2000 synthetic lease transaction.
>
> Following discussions with its independent auditors and outside advisors, and in view of anticipated changes in accounting rules governing these types of transactions and the desire to reach a final resolution of these matters as quickly as possible, the Company has decided that both transactions will be consolidated for financial accounting purposes in the restated reports and for future periods.
>
> Harry J. Phillips, Jr., the Company's chairman of the board, stated, "In today's market, we believe that the consolidated accounting treatment for the two transactions provides for greater transparency in our financial statements. Other than an equipment sale/leaseback for approximately $10 million, we have no other off balance sheet arrangements. Importantly, the consolidated accounting will not impact our current or future cash flow. We believe that these announced actions will position the Company as an even stronger competitor in the corrections, treatment and educational industry."
>
> The Company will file amended reports on Form 10-K/A for the fiscal year ended Dec. 31, 2000 and on Form 10-Q/A for each of the quarters ended March 31, 2001, June 30, 2001 and Sept. 30, 2001. The Company expects to file its restated reports with the SEC as soon as possible, but in no event later than the filing of the 2001 Form 10-K. Until restated results are released, financial statements for fiscal 2000 and the first three quarters of fiscal 2001, as well as the related Independent Auditors' Report for fiscal 2000, should not be relied upon. The Company's audit for the year ended Dec. 31, 2001 and the restated year ended Dec. 31, 2000 has not yet been completed. The Company currently intends to release the financial results for the year ended Dec. 31, 2001 and file its 2001 Form 10-K by March 29, 2002.
>
> The consolidation of the assets and liabilities from the August 2001 sale/leaseback transaction onto the Company's financial statements is expected to

> have a non-cash reduction of up to $0.05 on diluted earnings per share for the nine months ended Sept. 30, 2001. In addition, this consolidation is expected to result in an increase in the combined total assets and liabilities of the Company by approximately $198 million and $199 million, respectively, as of Sept. 30, 2001.
>
> The consolidation of the assets and liabilities from the 2000 synthetic lease transaction onto the Company's financial statements is expected to have no impact on earnings per share for 2000 and is expected to have a non-cash reduction of $0.01 diluted earnings per share for the nine months ended Sept. 30, 2001. In addition, this consolidation is expected to result in an increase in the combined total assets and liabilities of the Company by approximately $45 million as of Dec. 31, 2000 and by approximately $48 million as of Sept. 30, 2001.
>
> The effect of the restatement of the financials will require waivers of certain covenants under the Company's senior credit facility since the covenants, as defined, presume the August 2001 sale/leaseback transaction. Based on discussions with its lenders, the Company expects to reach agreement to waive and/or restructure the covenants.

42. On this news, Cornell's shares plummeted again by over 10%.

FALSE FINANCIAL STATEMENTS

43. In order to overstate its net income and EPS during the Class Period, defendants caused the Company to violate GAAP and SEC rules by failing to consolidate the results of a non-qualifying SPE, which, pursuant to GAAP, was required to be consolidated into Cornell's financial statements and should have reduced Cornell's earnings, and by improperly accounting for a synthetic lease transaction. Defendants' failure to consolidate Municipal Corrections Finance caused Cornell to omit millions in debt and fixed assets which should have been included on Cornell's balance sheets reported during the Class Period. Defendants' improper accounting for the synthetic lease caused Cornell's earnings and shareholders' equity to be misstated.

44. Cornell has since admitted that it is investigating to determine whether its third quarter 2001 results were false and improperly reported. The impact of correcting such an error "would have material financial consequences." Cornell has admitted that it will restate its results for 2000 and the first three quarters of 2001. The effect of the restatement was significant as it caused Cornell to violate debt covenants.

45. Cornell reported the following financial results during the Class Period:

	2000	**Q1 01**	**Q2 01**	**Q3 01**
Income From Operations	$29.061 M	$4.080 M	$7.551 M	$7.349 M
Total Assets	$291.380 M	$294.0 M	$298.593 M	$185.693 M
Debt	$146.926 M	$153.957 M	$159.488 M	$38.466 M
EPS	$0.84	$0.09	$0.22	$0.15
Shareholders Equity	$104.323 M	$105.480 M	$106.771 M	$109.221 M

46. Cornell included these results in press releases and in SEC filings, including its 2000 Form 10-K and its Form 10-Qs for the interim 2001 quarters. This SEC filings represented that the financial information was a fair statement of the Company's financial results and that the results were prepared in accordance with GAAP.

47. These representations were false and misleading as to the financial information reported, as such financial information was not prepared in conformity with GAAP, nor was the financial information "a fair presentation" of the Company's operations due to the Company's improper accounting for a non-qualifying SPE and improper accounting for synthetic leases, causing the financial results to be presented in violation of GAAP and SEC rules.

48. GAAP are those principles recognized by the accounting profession as the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. Regulation S-X (17 C.F.R. §210.4-01(a)(1)), states that financial statements filed with the SEC which are not prepared in compliance with GAAP are presumed to be misleading and inaccurate. Regulation S-X requires that interim financial statements must also comply with GAAP, with the exception that interim financial statements need not include disclosure which would be duplicative of disclosures accompanying annual financial statements. 17 C.F.R. §210.10-01(a).

Cornell's Failure to Consolidate a Special Purpose Entity

49. GAAP, as set forth in Accounting Research Bulletin ("ARB") No. 51 and as amended by FASB Statement of Financial Accounting Standards ("SFAS") No. 94, requires consolidation of

all majority-owned subsidiaries unless control is temporary or does not rest with the majority owner. ARB No. 51, ¶1, states in part:

> There is a presumption that consolidated statements are more meaningful than separate statements and that they are usually necessary for a fair presentation when one of the companies in the group directly or indirectly has a controlling financial interest in the other companies.

50. GAAP provides that certain qualifying SPEs do not have to be consolidated. SFAS No. 125 sets forth criteria for a qualifying SPE that must be met, including that it is a legal entity whose activities are limited by legal documents establishing the SPE to: (i) hold title to transferred assets; (ii) issue beneficial interests; (iii) collect cash proceeds from the assets and reinvest or distribute to holders of interests; and (iv) distribute proceeds to holders. It also must have standing apart from the transferor. SFAS No. 125, ¶26. *See also* FASB Emerging Issues Task Force Abstracts ("EITF") Nos. 96-20 and 96-21.

51. In August 2001, Cornell sold 11 properties to Municipal Corrections Finance. This entity was purportedly a qualifying SPE such that consolidation of their losses and debt on Cornell's financial statements was not required. In fact, this SPE was not a qualifying SPE and was controlled by Cornell personnel such that consolidation was required.

52. As a result, Cornell failed to record losses from this SPE and debt attributed to it.

53. Cornell has now admitted that a Special Committee of its Board of Directors has been formed to review the accounting for its August 2001 sale/leaseback transaction. The review is focused on a retainer agreement entered into with an investment bank in September 2001, which provided (i) that Cornell pay the investment bank a non-refundable retainer fee of $3.65 million to provide financial advisory services concerning future financing vehicles and the strategic development of Cornell's business, and (ii) that the retainer would be applied on a mutually agreed-upon basis toward future contingent fees associated with investment banking services that may be provided to Cornell. The inquiry focuses on whether the retainer agreement affects the previously reported accounting treatment for the August 2001 sale/leaseback transaction, and whether the amount paid the investment bank was appropriately reflected in the Company's financial statements.

54. The failure to consolidate also caused Cornell to report millions in shareholders equity which it was not entitled to report.

Cornell's Improper Accounting for a Synthetic Lease

55. Synthetic leases are leases which, under certain conditions, may be treated as operating leases for financial reporting purposes and as capital leases for tax purposes. By treating the leases as operating leases for financial reporting purposes, companies can avoid reporting long-term debt, depreciation and interest expenses and only report a periodic rental expense. However, where the synthetic lease does not meet the conditions for treatment as an operating lease, companies must report the lease as a capital lease such that expenses for interest and depreciation must be recognized, and long-term debt must be recorded.

56. GAAP, as set forth in FASB Statement of Financial Accounting Standard ("SFAS") No. 13, Accounting for Leases, requires that leases which meet any one of four criteria be treated as capital leases. SFAS No. 13, ¶6(a). A capital lease is recorded as an asset, with a corresponding amount of debt used to finance the asset. SFAS No. 13, ¶10, states in part:

> 10. The lessee shall record a capital lease as an asset and an obligation at an amount equal to the present value at the beginning of the lease term of minimum lease payments during the lease term, excluding that portion of the payments representing executory costs such as insurance, maintenance, and taxes to be paid by the lessor, together with any profit thereon.

This capital lease "asset" must also be amortized and expensed against earnings over the life of the asset. SFAS No. 13, ¶11. The criteria for accounting for leases is set forth in SFAS No. 13, ¶7:

> 7. The criteria for classifying leases set forth in this paragraph and in paragraph 8 derive from the concept set forth in paragraph 60. If at its inception (as defined in paragraph 5(b)) a lease meets one or more of the following four criteria, the lease shall be classified as a capital lease by the lessee. Otherwise, it shall be classified as an operating lease. (*See* Appendix C for an illustration of the application of these criteria.)
>
> a. The lease transfers ownership of the property to the lessee by the end of the lease term (as defined in paragraph 5(f)).
>
> b. The lease contains a bargain purchase option (as defined in paragraph 5(d)).
>
> c. The lease term (as defined in paragraph 5(f)) is equal to 75 percent or more of the estimated economic life of the leased property (as defined in paragraph 5(g))....

d. The present value at the beginning of the lease term of the minimum lease payments (as defined in paragraph 5(j)), excluding that portion of the payments representing executory costs such as insurance, maintenance, and taxes to be paid by the lessor, including any profit thereon, equals or exceeds 90 percent of the excess of the fair value of the leased property (as defined in paragraph 5(c)) to the lessor at the inception of the lease over any related investment tax credit retained by the lessor and expected to be realized by him.

57. In 2000, Cornell accounted for a synthetic lease as an operating lease rather than a capital lease. As a result, Cornell's assets and liabilities were understated by $45 million at December 31, 2000.

Cornell's Announcement Is an Admission the Prior Financial Statements Were Materially False

58. The fact that Cornell will restate its financial statements for 2000 and the first three quarters of 2001 is an admission that the financial statements originally issued were false and that the overstatement of revenues and income was material. Pursuant to GAAP, as set forth in Accounting Principles Board Opinion ("APB") No. 20, the type of restatement announced by Cornell was to correct for material errors in its previously issued financial statements. *See* APB No. 20, ¶¶7-13. The restatement of past financial statements is a disfavored method of recognizing an accounting change as it dilutes confidence by investors in the financial statements, it makes it difficult to compare financial statements and it is often difficult, if not impossible, to generate the numbers when restatement occurs. *See* APB No. 20, ¶14. Thus, GAAP provides that financial statements should only be restated in limited circumstances, *i.e.*, when there is a change in the reporting entity, there is a change in accounting principles used or to correct an error in previously issued financial statements. Cornell's restatement was not due to a change in reporting entity or a change in accounting principle, but rather was due to errors in previously issued financial statements. Thus, the restatement is an admission by Cornell that its previously issued financial results and its public statements regarding those results were false and misleading.

Cornell's Financial Statements Violated GAAP

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

(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);

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

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

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

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

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

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

(h) The principle that conservatism be used as a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered was violated. The best way to avoid injury to investors is to try to ensure that what is reported represents what it purports to represent (FASB Statement of Concepts No. 2, ¶¶95, 97).

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

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

61. At all relevant times, the market for Cornell's common stock was an efficient market for the following reasons, among others:

(a) Cornell's common stock met the requirements for listing, and was listed and actively traded on the NYSE, which is a highly efficient and automated market;

(b) As a regulated issuer, Cornell filed periodic public reports with the SEC and the NYSE;

(c) Cornell regularly communicated with public investors via established market communication mechanisms, including through regular disseminations of press releases on the national circuits of major newswire services and through other wide-ranging public disclosures, such as communications with the financial press and other similar reporting services; and

(d) Cornell was followed by several securities analysts employed by major brokerage firms who wrote reports which were distributed to the sales force and certain customers of their respective brokerage firms. Each of these reports was publicly available and entered the public marketplace.

62. As a result of the foregoing, the market for Cornell's common stock promptly digested current information regarding Cornell from all publicly available sources and reflected such information in the price of Cornell's common stock. Under these circumstances, all purchasers of

Cornell's common stock during the Class Period suffered similar injury through their purchase of Cornell's common stock at artificially inflated prices and a presumption of reliance applies.

FIRST CLAIM FOR RELIEF

Violation of Section 10(b) of the Exchange Act and Rule 10b-5 Promulgated Thereunder Against All Defendants

63. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

64. During the Class Period, defendants carried out a plan, scheme and course of conduct which was intended to and, throughout the Class Period, did: (i) deceive the investing public regarding Cornell's business, operations, management and the intrinsic value of Cornell common stock; and (ii) enable Cornell to sell 3.45 million shares of its common stock at $14 per share in a November 2001 secondary offering pursuant to a Prospectus Supplement dated November 27, 2001.

65. Defendants (a) employed devices, schemes, and artifices to defraud; (b) made untrue statements of material fact and/or omitted to state material facts necessary to make the statements made not misleading; and (c) engaged in acts, practices, and a course of business which operated as a fraud and deceit upon the purchasers of the Company's common stock in an effort to maintain artificially high market prices for Cornell's common stock in violation of §10(b) of the Exchange Act and Rule 10b-5. All defendants are sued either as primary participants in the wrongful and illegal conduct charged herein or as controlling persons as alleged below.

66. Defendants, individually and in concert, directly and indirectly, by the use, means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about the business, operations and future prospects of Cornell as specified herein.

67. These defendants employed devices, schemes and artifices to defraud, while in possession of material, adverse, non-public information and engaged in acts, practices, and a course of conduct as alleged herein in an effort to assure investors of Cornell's value and performance and continued substantial growth, which included the making of, or the participation in the making of, untrue statements of material facts and omitting to state material facts necessary in order to make

the statements made about Cornell and its business operations and future prospects in the light of the circumstances under which they were made, not misleading, as set forth more particularly herein, and engaged in transactions, practices and a course of business which operated as a fraud and deceit upon the purchasers of Cornell common stock during the Class Period.

68. Each of the Individual Defendants' primary liability, and controlling person liability, arises from the following facts: (a) the Individual Defendants were high-level executives and/or directors at the Company during the Class Period and members of the Company's management team or had control thereof; (b) each of these defendants, by virtue of his responsibilities and activities as a senior officer and/or director of the Company was privy to and participated in the creation, development and reporting of the Company's internal budgets, plans, projections and/or reports; (c) each of these defendants enjoyed significant personal contact and familiarity with the other defendants and was advised of and had access to other members of the Company's management team, internal reports and other data and information about the Company's finances, operations, and sales at all relevant times; and (d) each of these defendants was aware of the Company's dissemination of information to the investing public which they knew or recklessly disregarded was materially false and misleading.

69. The defendants had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain and to disclose such facts, even though such facts were available to them. Such defendants' material misrepresentations and/or omissions were done knowingly or recklessly and for the purpose and effect of concealing Cornell's operating condition and future business prospects from the investing public and supporting the artificially inflated price of its common stock. As demonstrated by defendants' overstatements and misstatements of the Company's business, operations and earnings throughout the Class Period, defendants, if they did not have actual knowledge of the misrepresentations and omissions alleged, were reckless in failing to obtain such knowledge by deliberately refraining from taking those steps necessary to discover whether those statements were false or misleading.

70. As a result of the dissemination of the materially false and misleading information and failure to disclose material facts, as set forth above, the market price of Cornell's common stock was artificially inflated during the Class Period. In ignorance of the fact that market price of Cornell's common stock was artificially inflated, and relying directly or indirectly on the false and misleading statements made by defendants, or upon the integrity of the market in which the stock trades, and/or on the absence of material adverse information that was known to or recklessly disregarded by defendants but not disclosed in public statements by defendants during the Class Period, plaintiff and the other members of the Class acquired Cornell common stock during the Class Period at artificially high prices and were damaged thereby.

71. At the time of said misrepresentations and omissions, plaintiff and other members of the Class were ignorant of their falsity, and believed them to be true. Had plaintiff and the other members of the Class and the marketplace known the truth regarding the problems that Cornell was experiencing, which were not disclosed by defendants, plaintiff and other members of the Class would not have purchased or otherwise acquired their Cornell common stock, or, if they had acquired such common stock during the Class Period, they would not have done so at the artificially inflated prices which they paid.

72. By virtue of the foregoing, defendants have violated §10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder.

73. As a direct and proximate result of defendants' wrongful conduct, plaintiff and the other members of the Class suffered damages in connection with their respective purchases and sales of the Company's common stock during the Class Period.

SECOND CLAIM FOR RELIEF

Violation of Section 20(a) of the Exchange Act Against All Defendants

74. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

75. Defendants Logan and Hendrix acted as controlling persons of Cornell within the meaning of §20(a) of the Exchange Act as alleged herein. Cornell controlled all of its employees

and each of the Individual Defendants. By virtue of their high-level positions, and their ownership and contractual rights, participation in and/or awareness of the Company's operations and/or intimate knowledge of the false financial statements filed by the Company with the SEC and disseminated to the investing public, the Individual Defendants had the power to influence and control and did influence and control, directly or indirectly, the decision-making of the Company, including the content and dissemination of the various statements which plaintiff contends are false and misleading. The Individual Defendants were provided with or had unlimited access to copies of the Company's reports, press releases, public filings and other statements alleged by plaintiff to be misleading prior to and/or shortly after these statements were issued and had the ability to prevent the issuance of the statements or cause the statements to be corrected.

76. In particular, each of these defendants had direct and supervisory involvement in the day-to-day operations of the Company and, therefore, is presumed to have had the power to control or influence the particular transactions giving rise to the securities violations as alleged herein, and exercised the same.

77. As set forth above, Cornell and the Individual Defendants each violated §10(b) and Rule 10b-5 by their acts and omissions as alleged in this Complaint. By virtue of their positions as controlling persons, defendants are liable pursuant to §20(a) of the Exchange Act. As a direct and proximate result of defendants' wrongful conduct, plaintiff and other members of the Class suffered damages in connection with their purchases of the Company's common stock during the Class Period.

PRAYER FOR RELIEF

WHEREFORE, plaintiff prays for relief and judgment, as follows:

A. Determining that this action is a proper class action, designating plaintiff as Lead Plaintiff and certifying plaintiff as a class representative under Rule 23 of the Federal Rules of Civil Procedure and plaintiff's counsel as Lead Counsel;

B. Awarding compensatory damages in favor of plaintiff and the other Class members against all defendants, jointly and severally, for all damages sustained as a result of defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;

C. Awarding plaintiff and the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

D. Such other and further relief as the Court may deem just and proper.

JURY DEMAND

Plaintiff demands a trial by jury.

DATED: March __, 2002

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