

**UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK**

STEVEN SCHMALZ, on Behalf of Himself and all Others Similarly Situated,	)	
	)	<b>CASE NO.</b>
Plaintiff,	)	
vs.	)	<b>CLASS ACTION COMPLAINT</b>
	)	<b>FOR VIOLATIONS OF</b>
AOL TIME WARNER INC., STEPHEN CASE, MICHAEL KELLY, RICHARD PARSONS and GERALD M. LEVIN,	)	<b>FEDERAL SECURITIES LAWS</b>
	)	<b><u>JURY TRIAL DEMANDED</u></b>
Defendants.	)	
	)	

Plaintiff has alleged the following based upon the investigation of plaintiff's counsel, which included a review of United States Securities and Exchange Commission ("SEC") filings by AOL Time Warner Inc. ("AOL Time Warner" or the "Company"), as well as regulatory filings and reports, securities analysts' reports and advisories about the Company, press releases and other public statements issued by the Company, and media reports about the Company, and plaintiff believes that substantial additional evidentiary support will exist for the allegations set forth herein after a reasonable opportunity for discovery.

**SUMMARY AND OVERVIEW**

1. This is a securities fraud class action on behalf of all purchasers of the publicly traded securities of AOL Time Warner between April 18, 2001 and April 24, 2002 (the "Class Period"), against AOL Time Warner and certain of its officers and directors for violations of the Securities Exchange Act of 1934 (the "Exchange Act"). AOL Time Warner is a media and communications company.

2. The Company was formed on January 11, 2001, when America Online and Time Warner consummated their merger, which had been pending completion since its announcement in January 2000. The merger was structured as a purchase of Time Warner by America Online. Following the merger, America Online and Time Warner became operating subsidiaries of AOL Time Warner.

3. On April 18, 2001, AOL Time Warner announced its financial results for the first time as a combined company. At or around the same time, the Company filed its Form 10-Q with the SEC for the first quarter, the period ending March 31, 2001. In the financial statements contained in that Form 10-Q, AOL Time Warner listed more than \$120 billion of goodwill, which represented more than 50% of the assets listed on the Company's balance sheet. The vast majority of the Company's goodwill was associated with the merger of AOL and Time Warner.

4. By the start of the Class Period, however, AOL Time Warner was required to take a substantial writedown of the value of its goodwill. It did not do so, thereby artificially inflating its financial results throughout the Class Period, as detailed in ¶¶ 34-45 below. The following factors, among others, required that AOL Time Warner write down billions of dollars of its goodwill earlier than it did:

(a) a material decline in the advertising market: the Company was experiencing a dramatic decline in demand for advertising, which had typically represented 20% of the Company's revenues. The decrease in advertising revenues had been escalating since the fourth quarter of 2000 and represented a significant and material adverse trend, which was known to, or recklessly disregarded by, defendants. Indeed, in the months prior to the consummation of the merger, America

Online, Inc. executives were advised that it faced the risk of losing more than \$140 million in ad revenue the following year; and

(b) the merger was not creating any synergies: the merger between America Online and Time Warner was not being effectively integrated and the Company lacked an effective plan to integrate the two companies. Accordingly, the merger was not creating any synergies.

5. In addition to publishing materially false and misleading financial statements and artificially inflating AOL Time Warner's operating results, defendants issued numerous materially false and misleading statements concerning the Company, the synergies derived from the merger, the Company's prospects and earnings projections. These statements were materially false and misleading when made because they failed to disclose the following material adverse facts which were known to defendants or recklessly disregarded by them, among others:

(a) that the merger was not generating the synergies anticipated at the time of its announcement;

(b) that the advertising market, upon which the Company heavily relied for the generation of revenues, was in the midst of a steep and severe decline such that the Company was not generating revenues from advertising that it anticipated. In addition, the Company's advertising operations were poorly coordinated;

(c) that the Company was failing to properly write down the value of more than \$50 billion of goodwill, thereby artificially inflating its reported operating results and rendering its published financial statements materially false and misleading and in violation of GAAP;

(d) that AOL Europe, a joint venture between the Company and Bertelsman AG, was not performing according to expectations and was operating at a significant loss. Although, defendants disclosed the possibility that Bertelsman would elect to “put” its share of AOL Europe to the Company for billions of dollars, the financial condition of AOL Europe and its prospects were never meaningfully disclosed;

(e) that America Online was experiencing a steep decline in online advertising revenues as customers were becoming increasingly dissatisfied with the results generated from advertising on AOL. In response, America Online was attempting to renegotiate a material portion of its advertising contracts by offering customers free offline advertising on Time Warner properties. Accordingly, defendants knew, or recklessly disregarded, that America Online’s future advertising revenues would decline markedly;

(f) that America Online was improperly inflating its reported advertising revenue by reporting revenues on “in-kind” advertising whereby America Online would provide customers with advertising on its website and in return receive certain advertising services which usually consisted of the right to advertise "America Online Keyword: [\_\_\_\_\_]" on a customer's product. The Company's reporting on the revenues on such in-kind advertising were inherently subjective and overstated; and

(g) that America Online was engaged in a series of short-term actions designed to inflate its advertising revenues in the near-term but which masked the decline in America Online's advertising revenues.

6. Prior to the disclosure of the true facts about the Company, AOL Time Warner insiders, including several of the Individual Defendants sold their personal holdings of AOL Time

Warner common stock to the unsuspecting public. In total, these sales, which are detailed further below, generated more than \$250 million in illicit proceeds.

### **JURISDICTION AND VENUE**

7. The claims asserted herein arise under and pursuant to Sections 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 SEC [17 C.F.R. § 240.10b-5].

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

9. 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.

### **THE PARTIES**

10. Plaintiff Steven Schmalz, as set forth in the accompanying certification, incorporated by reference herein, purchased the common stock of AOL Time Warner during the Class Period and has been damaged thereby.

11. Defendant AOL Time Warner Inc. is organized under the laws of Delaware and maintains its principal executive offices at 75 Rockefeller Plaza, New York, NY 10019. AOL Time Warner was formed in connection with the merger of America Online, Inc. and Time Warner Inc. which was consummated on January 11, 2001. As described in further detail herein, AOL Time Warner is a media and communications company.

12. Defendant Stephen Case ("Case") was AOL Time Warner's Chairman of the Board throughout the Class Period. During the Class Period, prior to the disclosure of the true facts concerning the Company, defendant Case sold 1 million shares of his personally-held AOL Time Warner common stock thereby generating \$50,366,184 in illicit proceeds.

13. Defendant Richard Parsons ("Parsons") served as AOL Time Warner's Chief Executive Officer and a Director since May 2002. Prior to that time, he served as Co-Chief Operating Officer since the merger. During the Class Period, prior to the disclosure of the true facts concerning the Company, defendant Parsons sold 700,000 shares of his personally-held AOL Time Warner common stock thereby generating \$35,267,400 in illicit proceeds.

14. Defendant Gerald M. Levin ("Levin") served as AOL Time Warner's Chief Executive Officer until his resignation from those positions in May 2002.

15. Defendant Michael Kelly ("Kelly") served as AOL Time Warner's Chief Financial Officer until November 1, 2001, when he assumed the position of Chief Financial Officer of the Company's AOL division. During the Class Period, prior to the disclosure of the true facts concerning the Company, defendant Kelly sold 200,000 shares of his personally-held AOL Time Warner common stock thereby generating \$9,852,710 in illicit proceeds.

16. Defendants Case, Parsons, Levin and Kelly are referred to collectively herein as the "Individual Defendants".

17. During the Class Period, each of the Individual Defendants, as senior executive officers and directors of AOL Time Warner was privy to confidential and proprietary information concerning AOL Time Warner, its operations, finances, financial condition, present and future business prospects.

The Individual Defendants also had access to material adverse non-public information concerning AOL Time Warner, as discussed in detail below. Because of their positions with AOL Time Warner, the Individual Defendants had access to non-public information about its business, finances, products, markets and present and future business prospects via access to internal corporate documents, 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. Because of their possession of such information, the Individual Defendants knew or recklessly disregarded the fact that adverse facts specified herein had not been disclosed to, and were being concealed from, the investing public.

18. Each of the defendants is liable as a direct participant in, and a co-conspirator with respect to the wrongs complained of herein. In addition, the Individual Defendants, by reason of their status as senior executive officers and directors were each a "controlling person" within the meaning of Section 20(a) of the Exchange Act and had the power and influence to cause the Company to engage in the unlawful conduct complained of herein. Because of their position of control, the Individual Defendants were able to and did, directly or indirectly, control the conduct of AOL Time Warner's business.

19. The Individual Defendants, because of their positions with the Company, controlled and/or possessed the authority to control the contents of its reports, press releases and presentations to securities analysts and through them, to the investing public. The Individual Defendants were provided with copies of the Company's reports and press releases alleged herein to be misleading, prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to

be corrected. Thus, the Individual Defendants had the opportunity to commit the fraudulent acts alleged herein

**FRAUDULENT SCHEME AND COURSE OF BUSINESS**

20. Defendants are liable for (i) making materially false statements, *or* (ii) failing to disclose adverse facts about AOL Time Warner's financial results. Defendants' fraudulent scheme and course of business that operated as a fraud or deceit on purchasers of AOL Time Warner publicly traded securities was a success, as it: (i) deceived the investing public regarding AOL Time Warner's prospects and business; (ii) artificially inflated the prices of AOL Time Warner publicly traded securities; (iii) caused plaintiff and other members of the Class to purchase AOL Time Warner publicly traded securities at inflated prices; and (iv) allowed certain of the Individual Defendants and other AOL Time Warner insiders to sell or dispose of 5,466,530 shares of their AOL Time Warner stock for proceeds of \$255,588,260.88.

**DEFENDANTS' FALSE AND MISLEADING STATEMENTS ISSUED DURING THE CLASS PERIOD**

21. On April 18, 2001, AOL Time Warner issued a press release announcing its financial results for the first quarter of 2001, the period ending March 31, 2001. The Company reported total revenues of \$9.1 billion and EBITDA [Earnings Before Interest Taxes Depreciation Amortization] of \$2.1 billion. The Company further reported "strong growth in advertising" with "year-over-year increases of 37% at America Online and 17% at Time Warner Cable." In the financial statements included in the press release, AOL Time Warner listed \$127,907,000,000 of Goodwill and other intangible assets. Defendant Levin commented on the results stating in pertinent part as follows:

We couldn't be more pleased with AOL Time Warner's performance in our first quarter as a new Company. Our results met or exceeded all key operating and financial targets. This outstanding quarter underscores the unique promise of AOL Time Warner, and the ability of our management team to collaborate in a focused, disciplined way. And this is just the beginning.

Our businesses are working together as one, unified organization to deliver shareholder value over the near- and long-term. We're aggressively rolling out next-generation products and services that will fuel continued growth momentum in our subscription and advertising commerce businesses. And we're continuing to develop high-quality entertainment that expands our immensely valuable film, video and music libraries. At the same time, we're laying the groundwork for truly transformational business like digital music, interactive television and broadband services.

22. Subsequent to the release of its first quarter results, AOL Time Warner held a conference call for securities analysts, money and portfolio managers, institutional investors, brokers and stock traders to discuss the Company's business and its prospects. During the call, defendant Levin directly disseminated important information to the market by stating:

! that the Company was "on track for full year targets of 40 billion in revenues and 11 billion in EBITDA";

! that the AOL division was the "jewel in the crown of the company" and it continues to "drive growth across all of our businesses;" and

! that the integration of AOL and Time Warner was a success and that the two companies were a "closely knit team."

23. The statements referenced above in ¶¶ 21 and 22 each were materially false and misleading when made. The true but concealed facts were:

(a) that the merger was not generating the synergies anticipated at the time of its announcement;

(b) that the advertising market, upon which the Company heavily relied for the generation of revenues, was in the midst of a steep and severe decline such that the Company was not generating revenues from advertising that it anticipated. In addition, the Company's advertising operations were poorly coordinated;

(c) that the Company was failing to properly write down the value of more than \$50 billion of goodwill, thereby artificially inflating its reported operating results and rendering its published financial statements materially false and misleading and in violation of GAAP;

(d) that AOL Europe, a joint venture between the Company and Bertelsman AG, was not performing according to expectations and was operating at a significant loss. Although, defendants disclosed the possibility that Bertelsman would elect to “put” its share of AOL Europe to the Company for billions of dollars, the financial condition of AOL Europe and its prospects were never meaningfully disclosed;

(e) that America Online was experiencing a steep decline in online advertising revenues as customers were becoming increasingly dissatisfied with the results generated from advertising on AOL. In response, America Online was attempting to renegotiate a material portion of its advertising contracts by offering customers free offline advertising on Time Warner properties. Accordingly, defendants knew, or recklessly disregarded, that America Online's future advertising revenues would decline markedly;

(f) that America Online was improperly inflating its reported advertising revenue by reporting revenues on “in-kind” advertising whereby America Online would provide customers with advertising on its website and in return receive certain advertising services which usually consisted of the

right to advertise "America Online Keyword: [\_\_\_\_\_]" on a customer's product. The Company's reporting on the revenues on such in-kind advertising were inherently subjective and overstated; and

(g) that America Online was engaged in a series of short-term actions designed to inflate its advertising revenues in the near-term but which masked the decline in America Online's advertising revenues.

24. On July 18, 2001, AOL Time Warner issued a press release announcing its financial results for the second quarter of 2001, the period ending June 30, 2001. The Company reported revenues of \$9.2 billion and EBITDA of \$2.5 billion. Defendant Levin commented on the results stating in pertinent part as follows:

We couldn't be more proud of what we accomplished this quarter. We achieved outstanding bottom-line results, dramatic improvement in profit margins and a huge increase in Free Cash Flow. Our record results are further proof that we are delivering in the promise of the AOL Time Warner merger.

In just six months, we've made great progress integrating the Company. We plan to continue this focus throughout the year, driving efficiencies and taking advantage of cross-company synergies. Our subscription businesses are continuing to show robust growth and, as planned, we are looking forward to a strong second half for Film and Music. We've just begun to tap our enormous potential.

25. On September 24, 2001, AOL Time Warner issued a press release commenting on its business outlook for 2001 and 2002. Citing a slowdown in the advertising market, among other factors, the Company reported that it now "expects to achieve full-year 2001 EBITDA growth in the 20% range and revenue growth of 5% to 7%." The press release stated in pertinent part as follows:

Looking ahead, the Company said that, despite recent events, its strategic and financial position remains very strong. Specifically, the Company stated that the recurring aspect of its subscription businesses and the attractive nature of its content businesses, which together make up more than 75% of total revenue, should not be meaningfully impacted.

As a result, despite the current uncertainty of the economic environment, the Company still expects double-digit 2002 EBITDA growth.

26. On October 17, 2001, AOL Time Warner issued a press release announcing its financial results for the third quarter of 2001, the period ending September 30, 2001. The Company reported that total revenues rose 6% to \$9.3 billion and that EBITDA increased 20% to \$2.5 billion. The Company reported that it was carrying \$126,942,000,000 of goodwill and other intangible assets. Defendant Levin commented on the financial results stating in pertinent part as follows:

The keys to our success in this difficult environment are clear. AOL Time Warner greatly benefits from the diversity of our revenue streams and the quality of our assets, built on a strong strategic and financial foundation. This quarter's financial performance underscores the continuing power of our subscription businesses, as well as our excellent performance in Filmed Entertainment and continuing focus on controlling costs across the board. With AOL Time Warner businesses ranking at or near the top of every category, our unique mix of media properties ensures we are well positioned for future growth. [Emphasis added.]

27. On November 1, 2001, AOL Time Warner issued a press release announcing that it had named Michael Kelly, the Company's Executive Vice President and Chief Financial Officer, to become AOL's Chief Operating Officer. According to the press release, the appointment, and related staff changes, were "moves designed to further position America Online as a key driver of growth and convergence across the entire Company." Defendant Levin commented on the announcement stating in pertinent part as follows:

As Chief Operating Officer of America Online, Mike Kelly will be in the perfect position to further drive convergence across AOL Time Warner. He has played an instrumental role in the successful integration of the Company, developing close working relationships with all of our division CEOs. And as the lines between our divisions blur, he is now uniquely positioned to further advance America Online as the central growth engine of all of our media and entertainment businesses. AOL is propelling growth throughout the Company by helping to increase magazine

subscriptions, create box office hits, break new musical artists and sell new cable services. As we move into the broadband era, AOL will become even more valuable growth driver and no one knows better how to take advantage of this convergence than Mike Kelly. [Emphasis added.]

28. On December 5, 2001, AOL Time Warner issued a press release announcing a "Senior Management Succession Plan." According to the press release, the Company will implement a six month transition to a new leadership team whereby Levin will retire at the time of the Company's Annual Meeting in May 2002. The Company reported that Parsons would become the CEO of the Company and that Pittman would become the Company's sole Chief Operating Officer.

29. On January 7, 2002, AOL Time Warner issued a press release announcing, among other things, its preliminary results for fiscal 2001 and financial guidance for 2002. The Company reported that for 2001 it expects to post EBITDA growth of approximately 18% to just under \$10 billion. The Company further announced that it was acquiring Bertelsmann AG's 49% interest in AOL Europe for payments of \$5.3 billion on January 31, 2002, and \$1.45 billion in July 2002. With respect to 2002, the Company reported that it expects revenue growth of in the 5-8% range and EBITDA to increase in the 8-12% range. Finally, the Company reported that it would be writing down the value of its goodwill by "\$40-\$60 billion range" due to the implementation of new accounting standards.

30. On January 30, 2002, AOL Time Warner issued a press release announcing its financial results for the fourth quarter of 2002 and fiscal 2002, the period ending December 31, 2001. The Company reported revenues of \$38.2 billion and EBITDA of \$13.2 billion. Defendant Levin commented on the results stating in pertinent part as follows:

We continue to make great progress in our broadband strategy and are satisfied with our progress to date. AOL Time Warner has more broadband subscribers than any

other company, and last year we nearly doubled the number of digital and high-speed data customers and began offering multiple ISPs in 20 markets. Building out the broadband market will remain one of our highest priorities and most promising sources of growth, because it will allow us to offer a wide variety of premium services such as on-demand programming and digital music.

Looking ahead, we will continue, in both our U.S and international operations, to expand our subscriber base, launch new products and services and sustain the flow of exciting new content. We will also maintain our emphasis on financial discipline, pursuing further cost reductions and productivity improvements across the Company, beyond the substantial gains we made in 2001.

31. The statements referenced above in ¶¶ 24-30 each were materially false and misleading when made. The true but concealed facts were:

(a) that the merger was not generating the synergies anticipated at the time of its announcement;

(b) that the advertising market, upon which the Company heavily relied for the generation of revenues, was in the midst of a steep and severe decline such that the Company was not generating revenues from advertising that it anticipated. In addition, the Company's advertising operations were poorly coordinated;

(c) that AOL Europe, a joint venture between the Company and Bertelsman AG, was not performing according to expectations and was operating at a significant loss. Although, defendants disclosed the possibility that Bertelsman would elect to “put” its share of AOL Europe to the Company for billions of dollars, the financial condition of AOL Europe and its prospects were never meaningfully disclosed;

(d) that America Online was experiencing a steep decline in online advertising revenues as customers were becoming increasingly dissatisfied with the results generated from

advertising on AOL. In response, America Online was attempting to renegotiate a material portion of its advertising contracts by offering customers free offline advertising on Time Warner properties.

Accordingly, defendants knew, or recklessly disregarded, that America Online's future advertising revenues would decline markedly;

(e) that America Online was improperly inflating its reported advertising revenue by reporting revenues on "in-kind" advertising whereby America Online would provide customers with advertising on its website and in return receive certain advertising services which usually consisted of the right to advertise "America Online Keyword: [\_\_\_\_\_]" on a customer's product. The Company's reporting on the revenues on such in-kind advertising were inherently subjective and overstated; and

(f) that America Online was engaged in a series of short-term actions designed to inflate its advertising revenues in the near-term but which masked the decline in America Online's advertising revenues.

32. On April 24, 2002, AOL Time Warner issued a press release announcing its financial results for the first quarter of 2002, the period ending March 31, 2002. The Company reported revenues of \$9.8 billion, EBITDA of \$2.05 billion and a net loss of \$54.2 billion, or \$12.25 per share, for the quarter. According to the Company, in connection with the adoption of FAS 142, the new rules on goodwill, AOL Time Warner recognized a "one-time, non-cash charge that reduced the carrying value of the Company's goodwill by approximately **\$54 billion**.[Emphasis added.]" The press release further elaborated on the charge representing that the goodwill impairment is "associated solely with goodwill resulting from the merger" and "the amount of the impairment primarily reflects the decline in

the Company's stock price since the Merger was announced in January 2000." With respect to AOL, the Company reported that advertising revenues at that division had sharply declined 31%.

33. At the end of the Class Period, AOL Time Warner stock closed at \$19.30 per share, a decline of more than 66% from a Class Period high of \$56.60 per share.

**DEFENDANTS' FORWARD-LOOKING STATEMENTS  
ARE NOT PROTECTED BY THE SAFE HARBOR**

34. The statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false statements pleaded in this complaint. Many of the specific statements pleaded herein were not identified as "forward-looking statements" when made. To the extent there were any forward-looking statements, there were no meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the purportedly forward-looking statements. Alternatively, to the extent that the statutory safe harbor does apply to any forward-looking statements pleaded herein, defendants are liable for those false forward-looking statements because at the time each of those forward-looking statements was made, the particular speaker knew that the particular forward-looking statement was false, and/or the forward-looking statement was authorized and/or approved by an executive officer of AOL Time Warner who knew that those statements were false when made.

**AOL TIME WARNER'S FALSE FINANCIAL STATEMENTS**

35. Overstating the Company's net income and EPS during the Class Period, defendants caused the Company to violate GAAP and SEC rules by failing to record required write-downs of its goodwill and intangible assets associated with the merger of AOL and Time Warner.

36. AOL Time Warner included its financial results in Form 10-Qs and a 10-K filed with the SEC during the Class Period. The Form 10-Qs represented the following:

The accompanying consolidated financial statements are unaudited but in the opinion of management, contain all of the adjustments (consisting of those normal recurring in nature) considered necessary to present fairly the financial position and the results of operations and cash flows for the periods presented in conformity with generally accepted accounting principles applicable to interim periods.

37. This statement was materially false and misleading as the financial information reported in the Form 10-Qs (and 10-K), 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 intangible assets associated with the merger of AOL and Time Warner causing the financial results to be presented in violation of GAAP and SEC rules.

38. 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.

39. Moreover, pursuant to §13(b)(2) of the Securities Exchange Act of 1934, AOL Time Warner was required to:

(A) make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer; and

(B) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that –

(i) transactions are executed in accordance with management's general or specific authorization;

(ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles ....

40. During the Class Period, one of the largest items on AOL Time Warner's balance sheet was Goodwill and Intangible Assets. Because Goodwill and Intangible Assets were such a significant part of AOL Time Warner's financial statements, comprising more than half of total reported assets, the accounting treatment for them was crucial to the proper and accurate determination of AOL Time Warner's net income. Thus, by failing to properly value these assets, AOL Time Warner's management materially overstated the Company's book value and financial results during the Class Period.

41. GAAP, as set forth in FASB Statement of Standards ("SFAS") No. 121, which was applicable during much of the Class Period and has now been replaced by FAS 142, required that companies review long lived assets, including goodwill, to determine if the assets are impaired. SFAS No. 121, ¶¶5-6:

5. The following are examples of events or changes in circumstances that indicate that the recoverability of the carrying amount of an asset should be assessed:
  - a. A significant decrease in the market value of an asset
  - b. A significant change in the extent or manner in which an asset is used or a significant physical change in an asset
  - c. A significant adverse change in legal factors or in the business climate that could affect the value of an asset or an adverse action or assessment by a regulator
  - d. An accumulation of costs significantly in excess of the amount originally expected to acquire or construct an asset
  - e. A current period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with an asset used for the purpose of producing revenue.

6. If the examples of events or changes in circumstances set forth in paragraph 5 are present or if other events or changes in circumstances indicate that the carrying amount of an asset that an entity expects to hold and use may not be recoverable, the entity shall estimate the future cash flows expected to result from the use of the asset and its eventual disposition. Future cash flows are the future cash inflows expected to be generated by an asset less the future cash outflows expected to be necessary to obtain those inflows. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, the entity shall recognize an impairment loss in accordance with this Statement. Otherwise, an impairment loss shall not be recognized; however, a review of depreciation policies may be appropriate.

(Footnote omitted.)

42. During the Class Period, contrary to GAAP, AOL Time Warner failed to adequately reflect the deterioration in value of the goodwill so as to inflate reported earnings. In fact, AOL Time Warner management was aware of several factors which indicated that the goodwill was not worth anywhere near what AOL Time Warner reported in its financial statements:

! a material decline in the advertising market: the Company was experiencing a dramatic decline in demand for advertising, which had typically represented 20% of the Company's revenues. The decrease in advertising revenues had been escalating since the fourth quarter of 2000 and represented a significant and material adverse trend, which was known to, or recklessly disregarded by, defendants. Indeed, in the months prior to the consummation of the merger, America Online, Inc. executives were advised that it faced the risk of losing more than \$140 million in ad revenue the following year; and

! the merger between America Online and Time Warner was not being effectively integrated and the Company lacked an effective plan to integrate the two companies. Accordingly, the merger was not creating any meaningful synergies and its cash flows were adversely projected. In addition, given the problems at AOL Time Warner, the cash flows being generated by substantial assets were materially below projections thus diminishing present value and demonstrating impairment.

43. As a result of these factors, AOL Time Warner's management knew, or recklessly disregarded, that the goodwill would not provide the benefits estimated upon acquisition, but did not take required write-downs in order to report strong earnings.

44. 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).

45. 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.

### **ADDITIONAL SCIENTER ALLEGATIONS**

46. As alleged herein, defendants acted with scienter in that defendants knew that the public statements or documents issued or disseminated in the name of the Company were materially false and

misleading; knew that such statements or documents would be issued or disseminated to the investing public; and knowingly and substantially participated or acquiesced in the issuance or dissemination of such statements or documents as primary violations of the federal securities laws. As set forth elsewhere herein in detail, defendants, by virtue of their receipt of information reflecting the true facts regarding AOL Time Warner, their control over, and/or receipt and/or modification of the Company's allegedly materially misleading misstatements and/or their associations with the Company which made them privy to confidential proprietary information concerning AOL Time Warner, participated in the fraudulent scheme alleged herein.

47. Defendants' scienter is further evidenced by the insider trading of certain of the Individual Defendants and AOL Time Warner insiders as follows:

**George Vradenburg III - Executive Vice President**

<b>DATE</b>	<b>SHARES</b>	<b>PRICE</b>	<b>VALUE</b>
6/14/01	30,000	\$50.52	\$1,515,600
6/13/01	10,000	\$52.50	\$525,000
6/13/01	10,000	\$52.62	\$526,200
6/13/01	10,000	\$52.76	\$527,600
5/31/01	50,000	\$52.40	\$2,620,00
5/30/01	6,402	\$50.00	\$320,100
5/21/01	50,000	\$55.23	\$2,761,300
5/7/01	50,000	\$52.00	\$2,600,000
5/1/01	50,000	\$51.24	\$2,562,200
4/24/01	25,000	\$48.50	\$1,212,607.50
4/23/01	75,000	\$47.50	\$3,562,192.50

<b>TOTAL</b>	<b>366,402</b>		<b>\$18,732,800</b>
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**Richard D. Parsons - Chief Executive Officer and Director; Co-Chief Operating Officer**

<b>DATE</b>	<b>SHARES</b>	<b>PRICE</b>	<b>VALUE</b>
5/25/01	70,000	\$53.25	\$3,727,500
5/18/01	70,000	\$53.82	\$3,767,400
5/11/01	70,000	\$52.00	\$3,640,000
5/4/01	70,000	\$49.50	\$3,465,000
4/27/01	70,000	\$50.00	\$3,500,000
4/20/01	350,000	\$49.05	\$17,167,500
<b>TOTAL</b>	<b>700,000</b>		<b>\$35,267,400</b>

**David M. Colburn-Executive Vice President**

<b>DATE</b>	<b>SHARES</b>	<b>PRICE</b>	<b>VALUE</b>
5/21/01	30,000	\$55.69	\$1,670,601
4/25/01	30,000	\$48.30	\$1,449,000
4/23/01	30,000	\$47.73	\$1,431,750
<b>TOTAL</b>	<b>90,000</b>		<b>\$4,551,351</b>

**Robert Edward Turner- Vice Chairman/ Senior Advisor**

<b>DATE</b>	<b>SHARES</b>	<b>PRICE</b>	<b>VALUE</b>
5/14/01	343,344	\$52.85	\$18,146,485.76
4/19/01	1,000	\$48.95	\$48,954.90
<b>TOTAL</b>	<b>344,344</b>		<b>\$18,195,440.66</b>

**Kenneth B. Lerer - -Executive Vice President**

<b>DATE</b>	<b>SHARES</b>	<b>PRICE</b>	<b>VALUE</b>
5/10/01	200,000	\$52.63	\$10,526,560
<b>TOTAL</b>	<b>200,000</b>		<b>\$10,526,560</b>

**James L. Barksdale - Director**

<b>DATE</b>	<b>SHARES</b>	<b>PRICE</b>	<b>VALUE</b>
3/8/02	25,000	\$26.25	\$656,250
3/8/02	25,000	\$26.27	\$656,750
3/8/02	25,000	\$26.32	\$658,000
3/8/02	21,300	\$26.19	\$557,844.87
3/8/02	3,700	\$26.26	\$97,162
3/6/02	50,000	\$27.22	\$1,361,000
3/6/02	25,000	\$27.18	\$679,585
3/6/02	10,000	\$26.92	\$269,150
3/6/02	7,500	\$27.00	\$202,500
3/6/02	7,500	\$27.07	\$203,025
3/4/02	25,000	\$26.45	\$661,250
3/4/02	25,000	\$26.62	\$665,500
3/4/02	25,000	\$26.69	\$667,310
3/4/02	25,000	\$26.70	\$667,500

3/4/02	25,000	\$26.78	\$669,380
3/4/02	25,000	\$27.00	\$675,000
3/1/02	50,000	\$25.47	\$1,273,500
3/1/02	25,000	\$25.55	\$638,750
3/1/02	15,000	\$25.60	\$384,000
3/1/02	10,000	\$25.75	\$257,500
2/27/02	50,000	\$23.57	\$1,178,250
2/27/02	15,000	\$23.46	\$351,900
2/27/02	10,000	\$23.45	\$234,500
2/27/02	10,000	\$23.48	\$234,800
2/27/02	5,000	\$23.40	\$117,008
2/27/02	5,000	\$23.40	\$117,010
2/27/02	5,000	\$23.55	\$117,750
2/21/02	50,000	\$23.11	\$1,155,500
2/21/02	10,000	\$23.30	\$233,000
2/21/02	5,000	\$22.80	\$114,000
2/21/02	5,000	\$22.85	\$114,250
2/21/02	5,000	\$22.90	\$114,500
2/21/02	5,000	\$23.00	\$115,000
2/21/02	5,000	\$23.05	\$115,230
2/21/02	5,000	\$23.16	\$115,800
2/21/02	5,000	\$23.18	\$115,900
2/21/02	5,000	\$23.20	\$116,000
2/12/02	100,000	\$27.72	\$2,771,740
5/8/01	150,000	\$51.67	\$7,751,220
4/25/01	25,000	\$47.65	\$1,191,250
4/25/01	25,000	\$47.67	\$1,191,750
4/25/01	25,000	\$47.69	\$1,192,250

4/25/01	25,000	\$47.74	\$1,193,500
4/25/01	25,000	\$47.76	\$1,194,000
4/25/01	25,000	\$47.80	\$1,195,000
4/25/01	25,000	\$49.45	\$1,236,250
4/25/01	2,500	\$49.27	\$123,175
4/19/01	200,000	\$48.60	\$9,720,300
<b>TOTAL</b>	<b>1,277,500</b>		<b>\$45,321,789.87</b>

**Robert W. Pittman - Co Chief Operating Officer**

<b>DATE</b>	<b>SHARES</b>	<b>PRICE</b>	<b>VALUE</b>
5/7/01	250,000	\$51.52	\$12,880,025
4/19/01	250,000	\$48.10	\$12,025,000
<b>TOTAL</b>	<b>500,000</b>		<b>\$24,905,025</b>

**Mayo S. Stuntz- -Executive Vice President**

<b>DATE</b>	<b>SHARES</b>	<b>PRICE</b>	<b>VALUE</b>
5/7/01	120,000	\$51.92	\$6,230,400
5/7/01	30,000	\$51.92	\$1,557,600
<b>TOTAL</b>	<b>150,000</b>		<b>\$7,788,000</b>

**Stephen M. Case - Chairman**

<b>DATE</b>	<b>SHARES</b>	<b>PRICE</b>	<b>VALUE</b>
5/2/01	70,000	\$51.89	\$3,632,545
4/30/01	430,000	\$51.45	\$22,124,489
4/25/01	50,000	\$49.50	\$2,475,000
4/19/01	450,000	\$49.19	\$22,134,150

<b>TOTAL</b>	<b>1,000,000</b>		<b>\$50,366,184</b>
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**Frank J. Caufield - Director**

<b>DATE</b>	<b>SHARES</b>	<b>PRICE</b>	<b>VALUE</b>
4/30/01	42,200	\$51.47	\$2,172,034
4/30/01	7,800	\$51.47	\$401,466
<b>TOTAL</b>	<b>50,000</b>		<b>\$2,573,500</b>

**Michael J. Kelly - Chief Financial Officer**

<b>DATE</b>	<b>SHARES</b>	<b>PRICE</b>	<b>VALUE</b>
4/25/01	200,000	\$48.52	\$9,703,800
<b>TOTAL</b>	<b>200,000</b>		<b>\$9,703,800</b>

**Miles Gilburne- Director**

<b>DATE</b>	<b>SHARES</b>	<b>PRICE</b>	<b>VALUE</b>
4/25/01	57,000	\$49.30	\$2,810,100
4/25/01	35,000	\$49.25	\$1,723,750
4/25/01	26,500	\$49.09	\$1,300,885
4/25/01	20,000	\$49.40	\$988,000
4/25/01	18,500	\$49.14	\$909,090
4/25/01	16,500	\$49.35	\$814,275
4/25/01	10,000	\$49.21	\$492,100
4/25/01	10,000	\$49.38	\$493,800
4/25/01	6,500	\$49.34	\$320,710
<b>TOTAL</b>	<b>200,000</b>		<b>\$9,852,710</b>

**Daniel F. Akerson- Director**

<b>DATE</b>	<b>SHARES</b>	<b>PRICE</b>	<b>VALUE</b>
4/25/01	48,000	\$49.30	\$2,366,620.80
4/25/01	15,918	\$49.30	\$784,830.62
4/20/01	80,000	\$49.09	\$3,926,952
<b>TOTAL</b>	<b>143,918</b>		<b>\$7,078,403.42</b>

**Kenneth J. Novack- Vice Chairman**

<b>DATE</b>	<b>SHARES</b>	<b>PRICE</b>	<b>VALUE</b>
3/19/02	12,000	\$27.00	\$324,000
3/12/02	12,000	\$26.95	\$323,400
3/5/02	12,000	\$27.00	\$324,000
2/19/02	12,000	\$25.96	\$311,520
4/19/01	171,366	\$48.09	\$8,240,236.93
4/19/01	25,000	\$48.09	\$1,202,140
<b>TOTAL</b>	<b>244,366</b>		<b>\$10,725,296.93</b>

<i><b>NAME OF INSIDER</b></i>	<i><b>NUMBER OF SHARES</b></i>	<i><b>GROSS PROCEEDS</b></i>
<b>George Vradenburg III</b>	366,402	\$18,732,800
<b>Richard D. Parsons</b>	700,000	\$35,267,400
<b>David M. Colburn</b>	90,000	\$4,551,351
<b>Robert Edward Turner</b>	344,344	\$18,195,440.66
<b>Kenneth B. Lerer</b>	200,000	\$10,526,560
<b>James L. Barksdale</b>	1,277,500	\$45,321,789.87
<b>Robert W. Pittman</b>	500,000	\$24,905,025
<b>Mayo S. Stuntz</b>	150,000	\$7,788,000
<b>Stephen M. Case</b>	1,000,000	\$50,366,184
<b>Frank J. Caufield</b>	50,000	\$2,573,500
<b>Michael J. Kelly</b>	200,000	\$9,703,800

<b>Miles Gilburne</b>	200,000	\$9,852,710
<b>Daniel F. Akerson</b>	143,918	\$7,078,403.42
<b>Kenneth J. Novack</b>	244,366	\$10,725,296.93
<b>TOTALS:</b>	<b>5,466,530</b>	<b>\$255,588,260.88</b>

## UNDISCLOSED ADVERSE INFORMATION

48. The market for AOL Time Warner's common stock was open, well-developed and efficient at all relevant times. As a result of these materially false and misleading statements and failures to disclose, AOL Time Warner common stock traded at artificially inflated prices during the Class Period. The artificial inflation continued until the time AOL Time Warner revealed the truth regarding its goodwill. Plaintiff and other members of the Class purchased or otherwise acquired AOL Time Warner's common stock relying upon the integrity of the market price of the Company's common stock and market information relating to AOL Time Warner, and have been damaged thereby.

49. During the Class Period, defendants materially misled the investing public, thereby inflating the price of AOL Time Warner common stock, by publicly issuing false and misleading statements and omitting to disclose material facts necessary to make defendants' statements, as set forth herein not false and misleading. Said statements and omissions were materially false and misleading in that they failed to disclose material adverse information and misrepresented the truth about the Company, its business and operations, as detailed herein.

50. At all relevant times, the material misrepresentations and omissions particularized in this Complaint directly or proximately caused or were a substantial contributing cause of the damages sustained by plaintiff and other members of the Class. As described herein, during the Class Period, defendants made or caused to be made a series of materially false or misleading statements about AOL Time Warner's earnings. These material misstatements and omissions created in the market an unrealistically positive assessment of AOL Time Warner and its prospects and operations, thus causing the Company's common stock to be overvalued and artificially inflated at all relevant times. Defendants' materially false and misleading statements during the Class Period resulted in plaintiff and other members of the Class purchasing the Company's common stock at artificially inflated prices, thus

leading to their losses when the illusion was revealed, and the market was able to accurately value the Company.

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

51. At all relevant times, the market for AOL Time Warner's securities was an efficient market for the following reasons, among others:

(a) AOL Time Warner's stock met the requirements for listing, and was listed and actively traded on the NYSE, a highly efficient and automated market;

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

(c) AOL Time Warner 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) AOL Time Warner 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.

52. As a result of the foregoing, the market for AOL Time Warner's securities promptly digested current information regarding AOL Time Warner from all publicly available sources and reflected such information in AOL Time Warner's stock price. Under these circumstances, all purchasers of AOL Time Warner's securities during the Class Period suffered similar injury through

their purchase of AOL Time Warner's securities at artificially inflated prices and a presumption of reliance applies.

### **PLAINTIFF'S CLASS ACTION ALLEGATIONS**

53. 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 all those who purchased the securities of AOL Time Warner between April 18, 2001 to April 24, 2002, inclusive (the "Class Period") and who were damaged thereby. Excluded from the Class are defendants, the officers and directors of the Company, at all relevant times, 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.

54. The members of the Class are so numerous that joinder of all members is impracticable. AOL Time Warner common stock is actively traded on the New York Stock Exchange (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 hundreds or thousands of members in the proposed Class. Record owners and other members of the Class may be identified from records maintained by AOL Time Warner 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.

55. 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.

56. 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.

57. 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 and operations of AOL Time Warner; and

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

58. 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.

### **FIRST CLAIM FOR RELIEF**

#### **For Violation of §10(b) of the Exchange Act and Rule 10b-5 Against All Defendants**

59. Plaintiff incorporates ¶¶ 1-58 by reference.

60. During the Class Period, defendants disseminated or approved the false statements specified above, which they knew or recklessly disregarded were misleading in that they contained misrepresentations and failed to disclose material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

61. Defendants violated §10(b) of the Exchange Act and Rule 10b-5 in that they:

- a. Employed devices, schemes, and artifices to defraud;
- b. Made untrue statements of material facts or omitted to state material facts

necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

- c. Engaged in acts, practices, and a course of business that operated as a fraud or deceit upon plaintiff and others similarly situated in connection with their purchases of AOL Time Warner publicly traded securities during the Class Period.

62. Plaintiff and the Class have suffered damages in that, in reliance on the integrity of the market, they paid artificially inflated prices for AOL Time Warner publicly traded securities. Plaintiff and the Class would not have purchased AOL Time Warner publicly traded securities at the prices they paid, or at all, if they had been aware that the market prices had been artificially and falsely inflated by defendants' misleading statements.

63. As a direct and proximate result of defendants' wrongful conduct, plaintiff and the other members of the Class suffered damages in connection with their purchases of AOL Time Warner publicly traded securities during the Class Period.

## **SECOND CLAIM FOR RELIEF**

### **For Violation of §20(a) of the Exchange Act Against the Individual Defendants and AOL Time Warner**

64. Plaintiff incorporates ¶¶ 1-63 by reference.

65. By reason of their positions as officers and/or directors of AOL Time Warner, the Individual Defendants had the power and authority to cause AOL Time Warner to engage in the wrongful conduct complained of herein. AOL Time Warner controlled the Individual Defendants and

all of its employees. By reason of such conduct, these defendants are liable pursuant to §20(a) of the Exchange Act.

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 TRIAL DEMANDED**

Plaintiff hereby demands a trial by jury.

Dated: July 18, 2002

Respectfully submitted,

**MILBERG WEISS BERSHAD  
HYNES & LERACH LLP**

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