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7 Lead Counsel for Plaintiffs

8  
9 UNITED STATES DISTRICT COURT  
10 NORTHERN DISTRICT OF CALIFORNIA

11 ) No. 05-cv-3395-JF  
12 ARCHDIOCESE OF MILWAUKEE )  
SUPPORTING FUND, INC., On Behalf of ) CLASS ACTION  
13 Plaintiff and All Others Similarly Situated, )  
14 ) [CORRECTED] COMPLAINT FOR  
Plaintiff, ) VIOLATIONS OF THE FEDERAL  
15 ) SECURITIES LAWS  
vs. )  
16 )  
MERCURY INTERACTIVE )  
CORPORATION, AMNON LANDAN, ) DEMAND FOR JURY TRIAL  
17 DOUGLAS P. SMITH, ANTHONY )  
ZINGALE, SUSAN J. SKAER, BRAD )  
18 BOSTON, IGAL KOHAVI, CLYDE )  
OSTLER, GIORA YARON, YAIR SHAMIR, )  
19 DAVID JAMES MURPHY III, YUVAL )  
SCARLAT and BRYAN LEBLANC, )  
20 )  
21 Defendants. )  
22 )

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1 Plaintiff, individually and on behalf of all other persons similarly situated, by plaintiff's  
2 undersigned attorneys, for plaintiff's complaint against defendants, alleges the following based upon  
3 personal knowledge as to plaintiff and plaintiff's own acts, and upon information and belief as to all  
4 other matters, based on, inter alia, the investigation conducted by and through plaintiff's attorneys,  
5 which included, amongst other things, a review of the defendants' press releases, Securities and  
6 Exchange Commission ("SEC") filings by Mercury Interactive Corp. ("Mercury Interactive" or the  
7 "Company") and media reports about the Company. Plaintiff believes that substantial evidentiary  
8 support will exist for the allegations set forth herein after a reasonable opportunity for discovery.

### 9 SUMMARY AND OVERVIEW

10 1. This is a securities class action on behalf of all persons who purchased or acquired the  
11 securities of Mercury Interactive ("Mercury Interactive" or the "Company") between October 22,  
12 2003 and July 5, 2005 (the "Class Period").

13 2. Mercury Interactive claims to be in the business of providing software and services to  
14 the business technology optimization (BTO) marketplace. The Company's IT governance offerings  
15 are used to prioritize and automate IT business processes from demand through production. The  
16 Company's application delivery offerings enable customers to optimize custom-built and  
17 prepackaged software applications before they go into production. The Company's application  
18 management offerings enable customers to optimize business availability and problem resolution, as  
19 well as to proactively manage and automate the repair of production problems.

20 3. Unbeknownst to investors, defendants' *internal controls and corporate compliance*  
21 *during the Class Period were flawed and deficient.* Moreover, defendants concealed extraordinary  
22 auditing expenses during the Class Period, in connection with the "*highly likely*" *need to restate*  
23 *earnings for multiple quarters and years.*<sup>1</sup> Defendants were aware of their flawed and deficient  
24

25  
26  
27 <sup>1</sup> Although defendants were asked in November of 2004 by the SEC to look into the matter  
28 and have spent over \$1 million on audits prior to June 30, 2005, they still refuse to admit more than  
"highly likely" materiality and a "highly likely" need for earnings restatements. See ¶ 89.

1 controls and compliance practices from the very beginning of the Class Period and their concealment  
2 served to inflate the value of the stock during the Class Period.

3 4. As a result of the stock price inflation maintained during the Class Period, defendants  
4 achieved lucrative executive bonus executive compensation and enhanced employment agreements,  
5 serving to discourage insider trading. By concealing the Company's deficient and defective internal  
6 controls and corporate compliance, defendants were also *able to assure the successful resale of*  
7 *notes by selling holders in connection with its \$500 million convertible notes offering pursuant to*  
8 *the Company's registration statement/prospectus and themselves sell \$6.3 million in Company*  
9 *stock at inflated prices.*

10 5. Defendants' scheme served to maintain an inflated price of the stock through the end  
11 of the convertible notes offering period, followed by false and misleading disclosures serving to  
12 remove inflation from the price of the stock. Finally, on July 5, 2005, defendants finally revealed the  
13 shocking news about previously undisclosed accounting irregularities and the Company's ongoing  
14 internal investigation and auditing process, a process that had already incurred as much as \$1 million  
15 in undisclosed expenses. As a result, the price of Mercury Interactive stock tumbled \$7.67 or 16.7%  
16 from its interim high of \$45.88 on May 24, 2005, until the price of the stock bottomed on July 5,  
17 2005. On the news of July 5, 2005, the price of the Company's stock fell \$0.25, to \$37.96, *on*  
18 *unusually heavy volume of 12.2 million shares, nearly six times average volume.*

#### 19 JURISDICTION AND VENUE

20 6. The claims asserted arise under §§10(b) and 20(a) of the Securities Exchange Act of  
21 1934 ("Exchange Act") (15 U.S.C. §§78j(b) and t(a)) and Rule 10b-5 (17 C.F.R. §240.10b-5)  
22 thereunder. Jurisdiction is conferred by §27 of the Exchange Act (15 U.S.C. §aa), §22(a) of the  
23 Securities Act (15 U.S.C. §77v(a)) and 28 U.S.C. §1331. Venue is proper in this district pursuant to  
24 §27 of the Exchange Act, and 28 U.S.C. §1391(b) because the defendants maintain an office in this  
25 District and the wrongful conduct giving rise to the violations of law complained of herein, including  
26 the preparation and dissemination to the investing public of false and misleading information, took  
27 place in this district.



1 least \$1.8 million; (iii) 36 months of Company-paid health care coverage; (iv) a pro-rated target  
2 bonus for the year of termination (worth as much as \$750,000 in 2005); (v) 24 months' accelerated  
3 vesting of stock options or other equity awards; (vi) 12 months to exercise any options granted after  
4 the date of the Agreement or any options that have exercise prices above the fair market value of the  
5 Company's stock on the date of the Agreement; and (vii) full vesting of any outstanding award under  
6 the long-term incentive plan or for any award for which the performance period has not been  
7 completed (worth as much as \$1,600,000 in 2005). These benefits provided defendant Landan  
8 strong motivation to encourage the inflated value of the Company's stock, the sale of the Company  
9 and not engage in insider stock sales.

10 11. Defendant Douglas P. Smith ("Smith") was at all relevant times hereto Executive  
11 Vice President and Chief Financial Officer ("CFO") of Mercury Interactive. As CFO, Smith  
12 prepared, reviewed and signed the Registration Statement/prospectus and amendments, in  
13 connection with the notes offering. During the relevant period, defendant Smith received \$350,000  
14 in bonus compensation for the year ending December 31, 2004, tied to performance measures that  
15 included the inflated price of the Company's stock. In addition to this bonus compensation,  
16 defendant Smith received other non-salary compensation for the year ending December 31, 2004 of  
17 \$101,561. On December 20, 2004, the Company entered into an amended and restated change of  
18 control agreements with Smith, providing change of control severance benefits, including (i)  
19 severance pay equal to 12-months of the executive's base compensation and annual target bonus as  
20 of the date employment ceases; (ii) continued coverage under Mercury Interactive's health, life,  
21 dental and other insurance programs for the 12-month severance pay period; and (iii) accelerated  
22 vesting of all stock options, shares of restricted stock and other forms of long-term compensation  
23 held by the executive at the time of termination. These benefits provided defendant Smith strong  
24 motivation to encourage the inflated value of the Company's stock, the sale of the Company and not  
25 engage in insider stock sales.

26 12. Defendant Anthony Zingale ("Zingale") was at all relevant times hereto President,  
27 Chief Operating Officer and a director of Mercury Interactive. As a director and later as President,  
28 defendant Zingale prepared, reviewed and signed the Registration Statement/prospectus and

1 amendments, in connection with the notes offering. On December 1, 2004, the Company entered  
2 into an employment agreement with Anthony Zingale whereby Mr. Zingale would serve as the  
3 Company's president and chief operating officer. Amongst other things, the agreement provided  
4 benefits for employment termination by the Company without "cause" or by Zingale for "good  
5 reason", including (i) receipt of a severance payment equal to one year (or two years, if he has been  
6 employed for more than four years at the time of termination) of base salary and target bonus in  
7 effect as of the date of termination; (ii) continued coverage under the Company's health, life, dental  
8 and other insurance programs for the one or two-year severance pay period; and (iii) accelerated  
9 vesting of Zingale's outstanding options that would have vested, absent the end of employment,  
10 during the 12-month period following termination. On December 20, 2004, the Company entered  
11 into an amended and restated change of control agreements with Zingale, providing change of  
12 control severance benefits, including (i) severance pay equal to 12-months of the executive's base  
13 compensation and annual target bonus as of the date employment ceases; (ii) continued coverage  
14 under Mercury Interactive's health, life, dental and other insurance programs for the 12-month  
15 severance pay period; and (iii) accelerated vesting of all stock options, shares of restricted stock and  
16 other forms of long-term compensation held by the executive at the time of termination. These  
17 benefits provided defendant Zingale strong motivation to encourage the inflated value of the  
18 Company's stock, the sale of the Company and not engage in insider stock sales.

19 13. Defendant Susan J. Skaer ("Skaer") was at all relevant times hereto a Vice President,  
20 General Counsel and Secretary of the Company. Skaer prepared, reviewed and signed the  
21 Registration Statement/prospectus in connection with the notes offering. During the Class Period,  
22 defendant Skaer sold 18,000 shares of her Mercury Interactive stock, for proceeds of \$0.8 million.

23 14. Defendant David James Murphy III ("Murphy") was at all relevant times hereto a Sr.  
24 Vice President of Corporate Development of the Company. During the Class Period, defendant  
25 Murphy sold 40,000 shares of his Mercury Interactive stock, for proceeds of \$1.7 million.

26 15. Defendant Yuval Scarlet ("Scarlat") was at all relevant times hereto a Senior Vice  
27 President of Products of the Company. During the Class Period, defendant Scarlet sold 70,000 shares  
28 of his Mercury Interactive stock, for proceeds of \$3.2 million.

1           16. Defendant Bryan LeBlanc (“LeBlanc”) was at all relevant times hereto a Vice  
2 President of Finance of the Company. During the Class Period, defendant LeBlanc sold 7,000 shares  
3 of his Mercury Interactive stock, for proceeds of \$0.3 million.

4                   **DEFENDANTS’ CONTROL OVER MERCURY INTERACTIVE AND ITS**  
5                   **COMMUNICATIONS TO THE PUBLIC CONCERNING FINANCIAL RESULTS**

6           17. Each of the above officers and directors of Mercury Interactive, by virtue of their  
7 high-level positions with the Company and committee memberships, directly participated in the  
8 management of the Company, were directly involved in the day-to-day operations of the Company at  
9 the highest levels and were privy to confidential proprietary information concerning the Company  
10 and its business, operations, growth, financial statements and financial condition, as alleged herein.  
11 Said defendants were involved in drafting, producing, reviewing and/or disseminating the materially  
12 false and misleading press releases, statements and information alleged herein, knew or recklessly  
13 disregarded that materially false and misleading statements were being issued regarding the  
14 Company, and approved or ratified these statements, in violation of the federal securities laws.

15           18. In addition to the above-described involvement, each Individual Defendant had  
16 knowledge of Mercury Interactive’s problems. Each defendant was motivated to conceal such  
17 problems. Defendants Smith and Le Blanc, serving as CFO and VP of Finance, respectively,  
18 provided for financial reporting and communications with the market. Defendant Smith directed  
19 communications with the market, including conference calls, as well as internal reports showing  
20 Mercury Interactive’s forecasted and actual growth. Defendant Landan, serving as Chairman and  
21 CEO also provided for communications with the market, including conference calls, as well as  
22 reports on Company operations, financing and press releases issued by the Company.

23           19. Each Individual Defendant sought to demonstrate that he could lead the Company  
24 successfully and generate the growth expected by the market. Each Individual Defendant also owed  
25 a duty to the Company and its shareholders not to trade on inside information.

26                   **FRAUDULENT SCHEME AND COURSE OF BUSINESS**

27           20. Each defendant is liable for (a) making false statements, *or* (b) failing to disclose  
28 adverse facts known to him about Mercury Interactive. Defendants’ fraudulent scheme and course

1 of business that operated as a fraud or deceit on purchasers of Mercury Interactive publicly traded  
2 securities was a success, as it (a) deceived the investing public regarding Mercury Interactive's  
3 prospects and business; (b) artificially inflated the prices of Mercury Interactive's publicly traded  
4 securities; (c) facilitated continued sales of its \$500 million Zero Coupon Senior Convertible Notes  
5 due 2008; (d) allowed defendants to obtain larger bonuses which were directly tied to the Company's  
6 falsified performance; (e) provided defendants with an opportunity to successfully negotiate  
7 employment contracts on highly favorable terms; (f) allowed defendants to sell over 135,000 shares  
8 of Mercury Interactive stock at inflated prices, for proceeds of approximately \$6.1 million and (g)  
9 caused plaintiff and other members of the Class to purchase Mercury Interactive's publicly traded  
10 securities at inflated prices.

## 11 OVERVIEW OF THE FRAUD

12 21. Defendant Mercury Interactive provides software and services to the business  
13 technology optimization (BTO) marketplace. Its offerings consist of integrated software, services,  
14 and practices that enable companies to use a centralized approach to manage software applications  
15 and information technology (IT). The Company's IT governance offerings are used to prioritize and  
16 automate IT business processes from demand through production. The Company's application  
17 delivery offerings enable customers to optimize custom-built and prepackaged software applications  
18 before they go into production. The Company's application management offerings enable customers  
19 to optimize business availability and problem resolution, as well as to proactively manage and  
20 automate the repair of production problems.

21 22. In simplest terms, the Company is in the business of design and sales of software  
22 tools targeting overall corporate compliance, offering a variety of process and systems applications,  
23 including its "Sarbanes-Oxley IT Assessment Accelerator"<sup>2</sup>:

### 24 A Complete BTO Solution

25 Mercury Sarbanes-Oxley IT Assessment Accelerator is part of Mercury Quality  
26 Center™, an integrated suite of applications *that automate the processes, controls,*

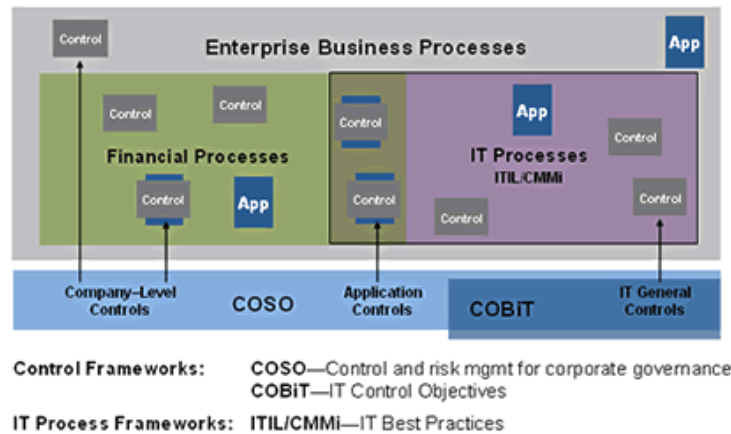
27 <sup>2</sup> See <http://www.mercury.com/us/solutions/sox/it-assessment-accelerator/works.html>, last  
28 accessed on August 19, 2005.

1 *audits, and assessments required for sustainable compliance.* Quality Center  
2 provides automated software testing and quality assurance across a wide range of IT  
and application environments.

3 Mercury Sarbanes-Oxley IT Assessment Accelerator and Mercury Quality Center are  
4 an integral part of Mercury’s overall Business Technology Optimization (BTO)  
5 strategy to provide integrated support for SOX compliance across Mercury  
Optimization Centers™.

6 23. In fact, defendants purport to be experts in the area of corporate compliance, going so  
7 far as to provide approaches for *analysis of deficiencies and achievement of compliance goals*, as  
8 further detailed on the Company’s website<sup>3</sup>:

### 9 SOX Landscape 10 Process and Control Frameworks



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18 Sustainable compliance with Sarbanes-Oxley means the death of “ad-hoc” IT  
19 processes. The Sarbanes-Oxley Section 404 affirmation requirement spans all  
20 processes that affect the business cycle of the company and any software applications  
21 used to support those processes, directly or indirectly. It also requires that these  
processes be effectively controlled.

22 Section 404 includes three control categories:

23 ***Company-Level controls (or Entity Controls), including enterprise policies,  
24 corporate governance, and information sharing;***

25 Application Controls for both financial/ERP systems and specialized applications,  
26 covering such areas as segregation of duty, authorization, validity, and accuracy

27 <sup>3</sup> See <http://www.mercury.com/us/solutions/sox/process-control-frameworks/>, last accessed on  
28 August 19, 2005.

1 IT General Controls, governing program development, program changes, computer  
2 operations, and access to programs and data; and

3 ***Mercury's Sarbanes-Oxley Accelerators address all three control categories,***  
4 ***enabling companies to automate and enforce their compliance processes.***

5 24. The Class Period begins on October 22, 2003, when defendants provided actual 4Q03  
6 and projected 1Q04 GAAP and non-GAAP financial results prone to error and manipulation, since  
7 defendants' internal controls and compliance practices were deficient and defective, to the extent  
8 that they would cause unprecedented auditing activities culminating in the disclosure of the "very  
9 likely" need to restate financial results over multiple quarters and years. Moreover, defendants  
10 introduced confusing business metrics designed to convince investors that, amongst other things, the  
11 Company's business now lacked seasonality. Then, in December of 2004, defendants Landan and  
12 Smith made false and misleading statements and omissions within defendants' registration  
13 statements/prospectus and prospectus supplements. As early as November of 2004, defendants were  
14 aware and actively concealed the fact that the SEC had commenced an informal inquiry into the  
15 Company's accounting practices and internal controls, as they related to compensation issues,  
16 including stock options.

17 25. Defendants concealed information about the SEC inquiry until the end of the Class  
18 Period, including the fact that the inquiry posed real prospects for financial restatements, involving  
19 one or more quarters. Moreover, defendants concealed the costs of its internal investigation and  
20 auditing process, in connection with the inquiry.

21 26. As early as March 9, 2005, Company defendants embarked on a further scheme to  
22 provide false and misleading financial guidance in furtherance of efforts to maintain an inflated price  
23 of the stock through the close of the period in which defendants were obligated to issue registration  
24 statements/prospectus and prospectus supplements for the benefit of its reselling convertible  
25 noteholders. Through the end of the Class Period, defendants cleverly stated assurances to analysts  
26 that the Company was able to achieve ambitious goals and overly aggressive guidance for 2005,  
27 including \$1 billion in revenues for 2005. Defendants, aware of their false and misleading statements  
28 secretly engaged in an evaluation of its operations, as the overall business environment for its

1 products deteriorated. This evaluation determined restructuring costs necessary to realign the  
2 Company's business operations with the market during the second half of 2005.

3 27. Then, on April 28, 2005, defendants boldly increased their previous 2005 annual  
4 guidance, serving to affirm prior statements that the Company was continuing in the direction of \$1  
5 billion in revenues for 2005. Unbeknownst to investors, and in spite of false and misleading positive  
6 comments about the Company's Sarbanes-Oxley compliance efforts, defendants' internal controls  
7 and corporate compliance was flawed and deficient. Moreover, defendants concealed extraordinary  
8 auditing expenses during the Class Period, in connection with the "highly likely" need to restate  
9 earnings for multiple quarters and years. Defendants were aware of their flawed and deficient  
10 controls and compliance practices from the very beginning of the Class Period and their concealment  
11 served to inflate the value of the stock during the Class Period.

12 28. As a result of the stock price inflation maintained during the Class Period, defendants  
13 achieved lucrative executive bonus executive compensation and enhanced employment agreements,  
14 serving to discourage insider trading. By concealing the Company's deficient and defective internal  
15 controls and corporate compliance, defendants were also able to assure the successful resale of notes  
16 by selling holders in connection with its \$500 million convertible notes offering pursuant to the  
17 Company's registration statement/prospectus and themselves sell \$6.3 million in Company stock at  
18 inflated prices.

19 29. Defendants' scheme served to maintain an inflated price of the stock through the end  
20 of the convertible notes offering period, followed by false and misleading disclosures serving to  
21 remove inflation from the price of the stock. On May 16, 2005, defendants took their first bite out of  
22 their inflated 2005 annual guidance. While reporting an "unlimited upside" for every line of its  
23 business, defendants positioned their incredible 2005 forecast against reported first quarter EPS  
24 growth of 55%, knowing that revenues for the 1Q05 were actually down 5.5 million or over 2%  
25 versus 4Q05.

26 30. Then, on June 13, 2005, defendants resorted to false and misleading responses to  
27 questions about the deteriorating business environment faced by enterprise software vendors like  
28 Mercury Interactive. Capitalizing on analyst fears about the unwillingness of customers to spend

1 money, defendants created doubts about the Company's guidance and financial performance during  
2 the second half of 2005. Although defendants were more than willing to talk the market down with  
3 their "speculation" as to the market forces that could undermine their incredible 2005 forecast, at no  
4 time did defendant relent in their knowing and active concealment.

5 31. Finally, on July 5, 2005, defendants finally revealed the shocking news about  
6 previously undisclosed accounting irregularities and the Company's ongoing internal investigation  
7 and auditing process, a process that had already incurred as much as \$1 million in undisclosed  
8 expenses. The investment community was finally now in possession of the reasons behind defendant  
9 Landan's false and misleading presentations of May 16, 2005 and June 13, 2005. Investors now  
10 understood issues at the root of the lowered guidance and negative disclosures, including the  
11 Company's review of its business operations "over the past several months". However, defendant  
12 continued in their attempts to minimize their disclosures: defendants now explained that the purpose  
13 of the undisclosed business operations review was "to position us to execute in the second half of  
14 2005", while a corrected press release was required to disclose the highly material fact that "[t]hese  
15 actions will result in third quarter restructuring charges".

16 32. As a result, the price of Mercury Interactive stock tumbled \$7.67 or 16.7% from its  
17 interim high of \$45.88 on May 24, 2005, until the price of the stock bottomed on July 5, 2005. On  
18 the news of July 5, 2005, the price of the Company's stock fell \$0.25, to \$37.96, on *unusually heavy*  
19 *volume of 12.2 million shares, nearly six times average volume.*

20 33. During the Class Period, defendants knew and concealed that the Company:

21 (a) employed *flawed and defective accounting practices and internal controls*,  
22 particularly those related to compensation issues, including stock options;

23 (b) issued *false and misleading financial statements and guidance*, serving to  
24 conceal the ramifications of *an SEC inquiry* into executive compensation matters;

25 (c) faced financial restatements, over at least a two year period;

26 (d) had issued untrue, false and misleading financial statements in connection  
27 with the resale of the Company's *\$500 million convertible notes offering*;

28

1 (e) *faced mounting costs for its internal investigation and auditing process* in  
2 connection with the SEC inquiry and restatement;

3 (f) would be *unable to achieve ambitious goals and aggressive guidance for*  
4 *2005*, despite repeated assurances to the contrary; and

5 (g) would need to undertake an evaluation of business operations, including  
6 *restructuring costs necessary to realign the Company's business operations with the market* during  
7 the second half of 2005.

#### 8 **BACKGROUND AND DEFENDANTS' PRE-CLASS STATEMENTS**

9 34. Mercury Interactive is an enterprise software company that provides software and  
10 services to the business technology optimization (BTO) marketplace. Its BTO offerings, known as  
11 Mercury Optimization Centers, consist of integrated software, services, and practices that enable  
12 companies to use a center of approach to govern the priorities, processes, and people of information  
13 technology (IT); deliver and manage applications; and integrate IT strategy and execution. The  
14 Company offers products and services in three product lines: IT governance, application delivery,  
15 and application management. The company's IT governance offerings are used to prioritize and  
16 automate IT business processes from demand through production.

17 35. Mercury Interactive's software solutions includes regulatory compliance verification  
18 software "at the press of a button", including the SOX IT Assessment Accelerator. Information about  
19 this software solution appearing on the Company's website is presented here, in pertinent part:

#### 20 ***Mercury Sarbanes-Oxley IT Assessment Accelerator***

#### 21 ***How it Works***

22 External auditors who evaluate management's assessment of internal controls want to  
23 see proof that adequate testing and all necessary remediation has been completed.  
24 ***That's where Mercury Sarbanes-Oxley IT Assessment Accelerator can add real  
25 value. At the press of a button, it automatically produces documentation to support  
26 this verification.*** Automated scripts reduce the cost of annual testing by more than 30  
27 percent. Auto-documentation also enables Sarbanes-Oxley and quality experts to  
28 work collaboratively.

26 With Mercury Sarbanes-Oxley IT Assessment Accelerator, ***you can achieve testing  
27 remediation and visibility with traceability from requirements to defects. Mercury's  
28 dashboard offers drilldown and visibility across all Sarbanes-Oxley projects.  
Traceability from requirements to defects also automates remediation and ensures  
complete coverage of all requirements.***

1 A Complete BTO Solution

2 Mercury Sarbanes-Oxley IT Assessment Accelerator is part of Mercury Quality  
3 Center™, an integrated suite of applications that automate the processes, controls,  
4 audits, and assessments required for sustainable compliance. Quality Center provides  
5 automated software testing and quality assurance across a wide range of IT and  
6 application environments.

7 Mercury Sarbanes-Oxley IT Assessment Accelerator and Mercury Quality Center are  
8 an integral part of Mercury's overall Business Technology Optimization (BTO)  
9 strategy to provide integrated support for SOX compliance across Mercury  
10 Optimization Centers™.

11 36. Mercury Interactive claims that its application delivery offerings enable customers to  
12 optimize custom-built and prepackaged software applications before they go into production. The  
13 Company's application management offerings enable customers to optimize business availability  
14 and problem resolution, as well as to proactively manage and automate the repair of production  
15 problems. In addition, the company provides a range of professional and educational services, as  
16 well as customer support offerings that enable partners and customers to implement, customize,  
17 manage, and extend its BTO offerings. The Company offers its products and services primarily  
18 through its direct sales organization, as well as through inside corporate sales professionals  
19 worldwide. The company has strategic alliances principally with Oracle, SAP AG, Siebel Systems,  
20 and Accenture.

21 37. On April 30, 2003, the Company filed SEC Form 10Q for the quarter ending March  
22 31, 2003. The filing stated in part:

23 NOTE 8 – SUBSEQUENT EVENT

24 We sold \$500.0 million of Zero Coupon Senior Convertible Notes due 2008  
25 (the Notes) in a private offering. The Notes were offered to investors at 100% of their  
26 principal amount. The sale of the Notes closed on April 29, 2003.

27 The Notes will not bear interest, have a zero yield to maturity, and will be  
28 convertible into our common stock at a conversion price of \$51.69 per share, subject  
to adjustment upon the occurrence of specified events. This represents a 43%  
conversion premium based on the closing price of \$36.15 of our common stock on  
April 23, 2003. Each \$1,000 principal amount at maturity will initially be convertible  
into 19.3461 shares of our common stock. However, holders of the Notes may  
convert their Notes only if: (1) the sales price of our common stock reaches a  
specified threshold, or (2) specified corporation transactions have occurred. Upon  
conversion, we will have the right to deliver cash in lieu of shares of our common  
stock. We may not redeem the Notes prior to their maturity.

1 The Notes were placed in a private transaction pursuant to Rule 144A under  
2 the Securities Act of 1933. Neither the Notes nor the common stock have been  
3 registered under the Act and may not be offered or sold in the United States absent  
4 registration or an applicable exemption from the registration requirements of the Act.

5 \*\*\*

#### 6 5. Other Information

7 On April 29, 2003, Mercury Interactive Corporation completed its sale of  
8 Zero Coupon Senior Convertible Notes due 2008 (the "Notes") in a private offering,  
9 which offering resulted in net proceeds to the Company of approximately \$488.0  
10 million. In addition, Mercury Interactive Corporation granted the initial purchaser of  
11 the Notes an option, exercisable through May 9, 2003, to purchase up to an  
12 additional \$100.0 million aggregate principal amount of the Notes. The Notes were  
13 issued pursuant to an Indenture, dated as of April 29, 2003, by and between Mercury  
14 Interactive Corporation and U.S. Bank National Association. The Notes and the  
15 shares of common stock issuable upon conversion of the Notes have not been  
16 registered under the Securities Act of 1933, as amended (the "Securities Act"), and  
17 may not be offered or sold in the United States absent registration or an applicable  
18 exemption from the registration requirements of the Securities Act. Mercury  
19 Interactive has agreed in a Registration Rights Agreement, dated as of April 23,  
20 2003, by and between Mercury Interactive Corporation and the initial purchaser of  
21 the Notes, for the benefit of the holders of the Notes, to file with the Securities and  
22 Exchange Commission a registration statement covering resales of the Notes and the  
23 shares of common stock issuable upon conversion of the Notes.

#### 24 Item 6. Exhibits and Reports on Form 8-K

##### 25 (a) Exhibits

26 4.1 Indenture, dated as of April 29, 2003, by and between Mercury  
27 Interactive Corporation and U.S. Bank National Association related to Zero Coupon  
28 Senior Convertible Notes due 2008.

4.2 Registration Rights Agreement, dated as of April 23, 2003, by  
and between Mercury Interactive Corporation and UBS Warburg LLC related to  
Zero Coupon Senior Convertible Notes due 2008.

4.3 Amendment No. 3 to Preferred Share Rights Agreement dated  
April 23, 2003, between Mercury Interactive Corporation and ChaseMellon  
Shareholder Services, LLC, as successor to Wells Fargo Bank National Association,  
as rights agent.

10.1 Confirmation regarding Swap Transaction from Goldman  
Sachs Capital Markets, L.P. dated November 5, 2002.

99.1 Certification of the Chief Executive Officer pursuant to 18  
U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act  
of 2002.

99.2 Certification of the Chief Financial Officer pursuant to 18  
U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act  
of 2002.

1 \*\*\*

2 38. In accordance with the pricing terms of the \$500 million in Zero Coupon Senior  
3 Convertible Notes due 2008 (“convertible notes”), the 10Q for the quarter ending March 31, 2003  
4 indicated that the Company initially sold its \$1000 principal amount notes (19.3461 shares, valued at  
5 maturity, at a threshold price of \$51.69 per share) to UBS Warburg, LLC, its initial purchaser, at  
6 discounted price, with the discount based on the cost of approximately \$699.36 (the present value of  
7 19.3461 shares, using defendants’ stated closing price of \$36.15 on April 23, 2003). Defendants’  
8 “conversion premium” of 43% results from the difference between the discounted price and the  
9 principal amount (\$1000 minus \$699.36, or \$300.64) divided by the discounted price. Thus,  
10 defendants actually sold \$1000 denominated convertible notes with an aggregate face value of \$715  
11 million, for proceeds of \$500 million.

12 39. On June 26, 2003, the Company filed SEC Form S-3, containing the preliminary  
13 prospectus for “\$500,000,000 MERCURY INTERACTIVE CORPORATION Zero Coupon Senior  
14 Convertible Notes due 2008 and 9,673,050 Shares of Common Stock Issuable Upon Conversion of  
15 the Notes”. The Registration Statement/Prospectus stated in part:

16  
17 **SELLING HOLDERS**

18 The Notes were originally issued by us and sold by the initial purchaser in a  
19 transaction exempt from the registration requirements of the Securities Act to  
20 persons reasonably believed by the initial purchaser to be qualified institutional  
21 buyers (as defined in Rule 144A under the Securities Act). Selling holders, including  
their transferees, pledgees or donees or their successors, may from time to time offer  
and sell pursuant to this prospectus any or all of the Notes and common stock into  
which the Notes are convertible.

22 \*\*\*

23 40. Thus, 9,673,050 shares of Mercury Interactive common stock was issuable upon  
24 conversion of the \$1000 denominated convertible notes, having an aggregate face value of \$715  
25 million, based on a threshold stock price of \$51.69. Defendants now undertook to periodically issue  
26 an updated prospectus supplement and/or amended registration statement, pursuant to registration  
27 statement/prospectus section entitled “REGISTRATION RIGHTS OF THE NOTEHOLDERS”  
28 contained within Form S-3 filed on June 26, 2003, stating in part:

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The registration statement of which this prospectus forms a part has been filed under the terms of a registration rights agreement, which we entered into with the initial purchaser of the Notes. In the registration rights agreement we agreed, for the benefit of the holders of the Notes and the shares of common stock issuable upon conversion of the Notes, that we would, at our expense:

- file with the SEC, within 90 days after the date the Notes were originally issued, the shelf registration statement of which this prospectus is a part covering resales of the registrable securities; and
- use our reasonable best efforts to cause the shelf registration statement to be declared effective under the Securities Act within 180 days after the date the Notes were originally issued.

We will use our reasonable best efforts to keep the shelf registration statement effective until the earliest of:

- the date when all of the registrable securities have been sold pursuant to the shelf registration statement or Rule 144 under the Securities Act, or any similar provision then in force, but not Rule 144A;
- the expiration of the holding period under Rule 144(k) under the Securities Act applicable to holders that are not affiliates of Mercury Interactive; and
- the date when all of the Notes and the shares of our common stock issuable upon conversion of the Notes have ceased to be outstanding (whether as a result of repurchase and cancellation, conversion or otherwise).

When we use the term “registrable securities” in this section, we are referring to the Notes and the common stock issuable upon conversion of the Notes until the earliest of:

- the effective registration under the Securities Act and the resale of the securities in accordance with the registration statement;
- the expiration of the holding period under Rule 144(k) under the Securities Act for holders that are not affiliates of Mercury Interactive; and
- the sale to the public pursuant to Rule 144 under the Securities Act, or any similar provision then in force, but not Rule 144A.

We may suspend the use of this prospectus under certain circumstances relating to pending corporate developments, public filings with the SEC and similar events. Any suspension period shall not:

- exceed an aggregate of 45 days for all suspensions in any 3-month period; or
- exceed an aggregate of 120 days for all suspensions in any 12-month period.

Notwithstanding the foregoing, we will be permitted to suspend the use of this prospectus for up to 60 days in any three-month period under certain circumstances relating to probable acquisitions, financings, recapitalizations, business combinations or other similar transactions. We need not specify the nature of the event giving rise

1 to a suspension in any notice to holders of the Notes of the existence of such a  
2 suspension. Each holder, by its acceptance of the Notes, agrees to hold any  
communication by us in response to a notice of a proposed sale in confidence.

3 \*\*\*

4 In order to be named as a selling securityholder in this prospectus at the time of  
5 effectiveness of the shelf registration statement, a holder must complete and deliver a  
6 signed notice questionnaire to us on or prior to the fifth business day before the  
7 effectiveness of the registration statement. Upon receipt of a completed questionnaire  
8 after that time, together with any other information we may reasonably request  
9 following the effectiveness, we will, subject to our rights to suspend the use of the  
10 prospectus, within ten business days use our reasonable efforts to add such holder to  
11 the shelf registration statement as a selling securityholder by means of a prospectus  
12 supplement, if permitted by the SEC; provided that any such failure to file such  
prospectus supplement will not result in the payment of additional interest and  
provided, further, that we will have no obligation to add a holder to the shelf  
registration statement if a post-effective amendment would be necessary to make  
such addition. If a holder does not complete and deliver a questionnaire or provide  
the other information we may request, that holder will not be named as a selling  
securityholder in this prospectus and will not be permitted to sell their registrable  
securities pursuant to the shelf registration statement.

13 41. The terms of the “Registration Rights” afforded the selling holders of the Company’s  
14 unregistered notes required the Company to periodically issue a prospectus supplement, to  
15 periodically update the information contained within the registration statement/prospectus, subject to  
16 the requirements and restrictions stated above. Moreover, subject to Rule 144(k) of the Securities  
17 Act, defendants were not required to keep their shelf registration effective beyond the two year  
18 period<sup>4</sup> when the selling holder acquired the notes from the Company’s affiliate. Finally, defendants  
19 were entitled to “suspend” the prospectus at any time, for the reasons and periods of time stated  
20 above, including pending corporate developments, public filings with the SEC and similar events.

21 **DEFENDANTS’ FALSE AND MISLEADING STATEMENTS**  
22 **MADE DURING THE CLASS PERIOD**

23 42. On October 22, 2003, the Company issued a press release entitled, “Mercury  
24 Interactive Reports Record Revenue of \$126 Million - Net Increase in Deferred Revenue: \$32.1

25 \_\_\_\_\_  
26 <sup>4</sup> Rule 144(k) of the Securities Act of 1933 states: “Termination of certain restrictions on sales of restricted  
27 securities by persons other than affiliates. The requirements of paragraphs (c), (e), (f) and (h) of this rule shall not apply  
to restricted securities sold for the account of a person who is not an affiliate of the issuer at the time of the sale and has  
not been an affiliate during the preceding three months, provided a period of at least two years has elapsed since the later

1 million - Earnings Per Share: \$(0.08) GAAP; \$0.23 Non-GAAP". The press release stated in  
2 part:

3 Sunnyvale, CA – October 22, 2003 – Mercury Interactive Corporation  
4 (NASDAQ: MERQ), the global leader in business technology optimization (BTO),  
today reported results for the third quarter ended September 30, 2003.

5 Revenue for the third quarter of 2003 was \$126.1 million, an increase of 29  
6 percent compared to \$97.9 million reported in the third quarter of 2002. Revenue for  
the first nine months of 2003 was \$354.5 million, an increase of 26 percent compared  
7 to \$282.4 million for the same period in 2002.

8 Deferred revenue for the third quarter of 2003 increased by \$32.1 million  
from the second quarter of 2003 to \$226.0 million. Cash generated from operations  
9 for the third quarter of 2003 was \$22.2 million compared to \$28.0 million in the third  
quarter of 2002. Net cash generated from operations in the third quarter of 2003 was  
10 reduced by \$8.0 million of prepaid royalties for the previously announced license of  
technology from Motive Communications, Inc.

#### 11 GAAP Results

12 Net loss for the third quarter of 2003 was \$6.7 million, or \$0.08 per basic  
share, compared to a profit of \$13.3 million, or \$0.15 per diluted share, for the same  
13 period a year ago. GAAP results for the third quarter include acquisition related  
charges of \$12.7 million, or \$0.13 per diluted share, related to the completion of the  
14 Kintana acquisition, as well as \$16.9 million, or \$0.18 per diluted share, of non-cash  
impairment charges relating to real-estate consolidation. Net income for the first nine  
15 months of 2003 was \$28.4 million, or \$0.31 per diluted share, compared to \$46.5  
million, or \$0.53 per diluted share, for the same period a year ago.

#### 16 Non-GAAP Results

17 Net income for the third quarter of 2003 was \$21.3 million, or \$0.23 per  
18 diluted share, compared to \$14.2 million, or \$0.16 per diluted share, for the same  
period a year ago. Non-GAAP earnings per share is calculated using fully diluted  
19 shares of 94.0 million. Net income for the first nine months of 2003 was \$60.0  
million, or \$0.66 per diluted share, compared to \$39.6 million, or \$0.45 per diluted  
20 share, for the same period a year ago. Non-GAAP results, as presented in the  
attached reconciliation table, exclude the following recurring items: expenses from  
21 acquisition and restructuring related charges, asset impairment charges related to real  
estate, gain on early retirement of debt, stock-based compensation and amortization  
22 of intangible assets, as well as related income tax provisions or benefits.

23 On August 15, 2003, Mercury completed its previously announced  
acquisition of Kintana, Inc. for approximately \$225.0 million in cash and stock.  
24 GAAP financial results for the quarter include an in-process R&D write-off and  
acquisition related expenses totaling \$12.7 million. In connection with the acquisition  
25 of Kintana, and to optimize the work environment for employees and customers, the  
company intends to move to a new headquarters campus in Mountain View, CA.  
26

27 of the date the securities were acquired from the issuer or from an affiliate of the issuer. The two-year period shall be  
28 calculated as described in paragraph (d) of this section."

1 Accordingly, third quarter GAAP results also include a non-cash charge of \$16.9  
2 million to reflect the impairment of a portion of the existing Sunnyvale facilities.

3 "In the third quarter Mercury had record revenues, strong deferred revenues,  
4 and a record number of large transactions, reflecting the adoption of Business  
5 Technology Optimization by our customers." said Amnon Landan, chairman, CEO  
6 and president of Mercury Interactive Corporation.

#### 7 Q3 2003 Highlights

8 Acceleration of business model with term licenses representing a record 46  
9 percent of new product orders

10 Strong net increase in deferred revenue of \$32.1 million, generated  
11 principally from term licenses

12 Record of eight transactions over \$1 million

13 Record application management results in both new orders and revenue

14 Largest technology launch in Mercury's history: BTO Technology Blueprint  
15 and Mercury Optimization Centers

#### 16 Financial Outlook

17 The following financial outlook is provided based on information as of  
18 October 22, 2003. Management initiates the following guidance for the quarter  
19 ending December 31, 2003:

20 Term licenses are expected to be in the range of 43 percent to 47 percent of  
21 new product orders

22 Revenue is expected to be in the range of \$140.0 million to \$148.0 million

23 Net increase in deferred revenue is expected to be in the range of \$35.0  
24 million to \$45.0 million

25 GAAP diluted earnings per share is expected to be in the range of \$0.18 to  
26 \$0.22

27 Non-GAAP diluted earnings per share is expected to be in the range of \$0.23  
28 to \$0.27

Cash flow from operations is expected to be in the range of \$40.0 million to  
\$55.0 million

Non-GAAP guidance is adjusted from GAAP guidance by excluding  
recurring acquisition and restructuring related charges and stock-based compensation  
and amortization of intangible assets of approximately \$5.0 million.

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43. Defendants' press release of October 22, 2003 was false and misleading. First,  
although defendants provided actual 3Q03 and projected 4Q03 GAAP and non-GAAP financial

1 results, those results were prone to error and manipulation, since defendants' internal controls  
2 and compliance practices were deficient and defective, to the extent that they would cause  
3 unprecedented auditing activities, culminating in the disclosure of the "very likely" need to  
4 restate financial results over multiple quarters and years. Financial statements and guidance  
5 resulting from deficient and defective internal controls and compliance practices generally *fail to*  
6 *conform to generally accepted accounting practices* ("GAAP"), to the extent of the  
7 ineffectiveness of the Company's controls and practices. Finally, to the extent defendants'  
8 concealed deficient and defective internal controls and compliance practices resulted in  
9 violations of GAAP and false and misleading financial statements and guidance, the Company  
10 was at risk of SEC inquiry and investigation.

11 44. On January 21, 2004, defendants conducted a conference call to report record  
12 revenues and cash flow for 4Q03. Defendants stated in part:

13

14 Amnon Landan - Mercury Interactive - Chairman, President and CEO

15 Good afternoon. Q4 was our best quarter ever. We had record revenues of \$152  
16 million, record growth in the deferred revenues of \$54.6 million, and record cash  
flow from operations of \$67 million.

17 In 2003 we made investments (indiscernible) Mercury optimization centers, the  
18 Mercury brand and our enterprise sales force. Clearly, these investment are  
delivering results today.

19 During Q4 Mercury crossed another important threshold with 51 percent of product  
20 orders coming as a term licenses. Our customers continue to shift from buying point  
21 tools sold as perpetual licenses to investing in testing in enterprise optimization  
centers sold on a term basis. This resulted in a record 19 deals over \$1 million, far  
exceeding our previous record of 8.

22 Now I would like to review key highlights from the quarter. Every region and every  
23 product line exceeded their targets in Q4. We believe that our Kintana business has  
24 turned the corner in this quarter. IT governance -- as we now call it -- did \$11.1  
25 million in revenues, exceeding our expectations and guidance for growth in the  
quarter. The combination of our strong offering, new sales leadership, and a high  
level of CIO interest creates the opportunity to make IT governance the fastest-  
growing part of our business in '04.

26 Mercury's results in application management were again very strong. We grew  
27 product orders 48 percent over a strong Q4 last year. Clearly we continue to take  
28 market share as customers shift spending away from legacy system management to  
investing in business technology optimization.

1 Mercury's results in application delivery -- our core testing business -- were  
2 impressive. We had strong product order growth of 24 percent over Q4 last year.  
3 Customers globally are extending their approach beyond testing to quality and  
performance at an enterprise level. Mercury's quality and performance centers are the  
foundation for an enterprise approach to application delivery.

4 As we had into '04, it is clear that the pressures facing IT executives have never been  
5 higher. CIOs are turning to business technology optimization to deliver high-quality  
6 business results at a lower cost. Mercury customers are adopting our new  
optimization centers as the foundation for BTO. As a result of this, we plan to grow  
new orders and cash flows in the range of 20 to 30 percent in '04.

7 Mercury has the offerings, brand, channel, and high-caliber people required to  
8 become one of the most important partners to our global customers. Last year, was a  
great year for Mercury and I believe that this year can be even better.

9 With that, I will turn it over to Doug to review our business model and financial  
10 results.

11 Doug Smith - Mercury Interactive - EVP & CFO

12 Thanks Amnon. Once again, the Mercury business model delivered across the board.  
13 Total orders grew in excess of 35 percent and our term license mix crossed 50  
14 percent. Fueling this accelerating mix shift was our application delivery business,  
with term licenses comprising 40 percent of new application delivery product orders.  
Also contributing was the continued strength in our application management  
business, accounting for 28 percent of new product orders.

15 Q4 saw more big deals and a larger percentage of term licenses, yet the average  
16 contract length of our deferred revenues remained at 23 months. Additionally, in Q4  
several customers renewed their term licenses by making significantly larger  
commitments and they accounted for many of our deals greater than \$1 million.

17 Over-achievement in new order growth also contributed to the record performance in  
18 deferred revenues. Of the \$54.6 million increase in deferred revenues, 40 million, or  
over 70 percent, came from deferred term licenses. This \$40 million sequential  
19 growth in term licenses represents a significant shift of earnings to the future.  
Approximately 4.5 million of the increase in deferred revenue was due to the  
20 revaluation effects of FX movements.

21 Total deferred revenue balance for Q4 was \$280.6 million, comprised of \$212.7  
22 million in short-term deferred revenue and \$67.9 million in long-term deferred  
revenue. Total term licenses in deferred revenue now equals \$150 million, or 53  
23 percent, of total deferred revenue, which compares with 38 percent at the end of Q4 a  
year ago.

24 All of our major geographies performed well this quarter. America has accounted for  
25 63 percent of our new business, with international contributing the remainder,  
highlighted by a strong showing in Europe in our application management business.  
26 Our partners provided approximately 30 percent of new business in the quarter, with  
Accenture being the standout performer. The packaged application business  
represented 27 percent of product orders.

27 Moving to our metrics on deals, deals over 100,000 exceeded 350 as compared with  
28 240 in Q3 '03 and 250 for the year ago period. Our field average deal size remained

1 at 150,000. We finished the quarter with approximately 270 direct sales teams with  
2 20 dedicated to IT governance and 40 supporting partners. In addition, we had 135  
corporate sales teams worldwide.

3 DSOs this quarter increased slightly to 85 days. Approximately 32 days in DSO was  
4 attributable to the growth in deferred revenue. We again collected over 160 percent  
of our opening receivable balance, and we kept our over ninety-day percentage to  
5 below three percent.

6 Cash from operations this quarter totaled \$67 million. This is the real indicator of the  
strength of our business this quarter.

7 Mercury continues to deliver superior productivity across the organization. Our non-  
GAAP operating margins were 18.8 percent in Q4.

8 To better assess the progress and quality of our business model, I will share with you  
9 the calculation of our operating efficiency ratio which we use as a metric to assess  
our productivity. We measured total operating expenses -- which were \$123.4  
10 million this quarter -- against our revenue and deferred revenue growth -- which  
totaled \$206.6 million in Q4. Calculated on this basis, our margins approach 40  
11 percent.

12 Before reviewing guidance, allow me to note that our full year tax rate declined  
modestly to 19.5 percent.

13 Now, on to guidance for Q1 2004. New orders are expected to grow in the range of  
14 22 to 27 percent. We expect the term license mix for new product orders to be in the  
range of 45 to 50 percent. As a result, we expect total revenues to be in the range of  
15 145 to \$155 million and deferred revenue growth of 10 to \$20 million. Depending on  
the revenue and deferred revenue resulting from our term license mix, we expect  
16 GAAP EPS to be in the range of 12 to 18 cents and non-GAAP EPS of 17 to 23 cents  
on approximately 98 to 99 million fully diluted shares. Non-GAAP EPS excludes  
17 stock based compensation, amortization of intangible assets of \$4.1 million, and the  
recurring milestone bonus payment of \$1 million. Cash from operations is expected  
18 to be in the range of 50 to \$60 million.

19 45. Moreover, defendants introduced new business metrics to highlight and “explain” to  
20 analysts that their business had undergone a dramatic transformation, *such that “seasonality” had*  
21 *been “abolished” from defendant’s business model and was no longer a key component in*  
22 *understanding defendants’ revenue prospects:*

23  
24 John Rizzuto - Credit Suisse First Boston - Analyst

25 Good afternoon. Very strong quarter. *Doug, I want to ask you about this new*  
26 *metric you're giving us -- new orders.* I don't believe you have ever given us that  
guidance before. Could you give us a little more granularity into exactly what that  
27 is? Is that just -- that's enough.

28 Doug Smith - Mercury Interactive - EVP & CFO

1 That's really what we expect to be the new business that we're going to book this  
2 quarter.

3 John Rizzuto - Credit Suisse First Boston - Analyst

4 Are your new orders -- are they always visible between the income statement and  
5 the balance sheet? Is any of that off the balance sheet that goes into that?

6 Doug Smith - Mercury Interactive - EVP & CFO

7 As I have said publicly on our calls and in our conferences and in our discussions  
8 and meetings, we believe that our revenue plus change in deferred revenue *is an  
9 excellent proxy for understanding our new business.*

10 John Rizzuto - Credit Suisse First Boston - Analyst

11 *Now, the revenue growth, you're going to 145 to 155. That's fairly strong  
12 considering the typical seasonality you experience.* I'm just thinking about the  
13 deferred growth of only 10 to 20 million. If I'm not mistaken, although last year's  
14 first quarter -- I'm not trying to put words in your mouth -- I'm just trying to  
15 understand why this year's guidance is the same as last year's guidance in the third  
16 and the total revenue looks to be so much higher. Is there more license coming  
17 through there or --?

18 Doug Smith - Mercury Interactive - EVP & CFO

19 John, I think if you note, last year our term license mix was substantially lower than  
20 this year -- well below 40 percent. And going into this year, we're saying it's going to  
21 be 45 to 50.

22 Put simply, the 145 to 155 and the 10 to 20 on deferred revenue is really a reflection  
23 of the 22 to 27 percent new order growth that we're expecting.

24 John Rizzuto - Credit Suisse First Boston - Analyst

25 Finally, just a little bit on the leverage -- the inherent leverage of the model. The 145  
26 to 155, that would get us right about where we are in this quarter's revenue, but yet  
27 we're going to see the operating EPS go down a little bit. What exactly is the places  
28 I've got to look at that is going to impact the EPS?

29 Doug Smith - Mercury Interactive - EVP & CFO

30 I think there's three things that you've got to understand about our operating model.  
31 First of all, we're running this company to drive our total new business (technical  
32 difficulty) that's how we make our decisions about investing in operating expenses.  
33 Secondly, we're bringing a breakeven business -- Kintana -- into the P&L and we've  
34 got the leverage it. Thirdly, we're investing in new businesses going into 2004 --  
35 Motive -- expanding our footprint in application management. Those are things we  
36 are all going to have to get leverage in the course of 2004 and we think we will so  
37 that when you look through the year of 2004, as Amnon noted, we would expect to  
38 see a similar business model to 2003.

39 John Rizzuto - Credit Suisse First Boston - Analyst

40 Good quarter again. Thanks.

1 46. Finally, defendants *reset expectations* by raising the issue that the Company would  
2 achieve a triggering event in terms of stock price, for the convertible notes:

3  
4 Sarah Friar - Goldman Sachs - Analyst

5 Doug, just the other area that's come up a lot around you guys is the convertible that  
6 obviously you have outstanding. Stock has gone up to an extent where at least from a  
7 strike price perspective it looks in the money, but you are giving guidance based on  
8 not assuming the convertible to be in the money. How are you talking to the Street  
9 and thinking about that going forward?

10 Doug Smith - Mercury Interactive - EVP & CFO

11 Sarah, with respect to the convertible, we characterize the convertible on our balance  
12 sheet as debt because, in fact, it does not meet the conditions for conversion.

13 ***Reminding everyone, the conditions for conversion are that the convertible has to***  
14 ***trade at or above \$56.89 -- 110 percent of the conversion price of the note for 20 of***  
15 ***the last 30 trading days of a quarter. That obviously didn't happen in Q4, and as***  
16 ***such we reported our numbers that way. It is impossible for me to know whether***  
17 ***it's going to happen in Q1, but you can expect that if it does that we would address***  
18 ***to the issue when Q1 comes around. So until we know that there is another way to***  
19 ***account for this stuff, there's no reason for us to do so.***

20 Sarah Friar - Goldman Sachs - Analyst

21 Thanks a lot.

22 47. Finally, defendants pointed to the increased revenue diversification, by pointing to the  
23 strength of the Company's business performance in the foreign markets, including Europe and Asia:

24 Sarah Mattson - RBC Capital Markets - Analyst

25 The next quick question on Europe. You mentioned that you did particularly well in  
26 Europe. Were there any particular drivers there, and can you give us a sense of the  
27 percentage of revenues that was specific to that region, and if there are any currency  
28 effects in the quarter?

Amnon Landan - Mercury Interactive - Chairman, President and CEO

As we mentioned in our comments, our application management business in Europe  
was especially strong. But we had an extremely strong performance across all of our  
European regions. Doug, any specifics --

Doug Smith - Mercury Interactive - EVP & CFO

No doubt our two strongest regions in Europe were the United Kingdom, and then a  
region we call NSE, North and South Europe, which basically covers the  
Scandinavian region, Benelux, and Italy, Spain territories. So all of -- those two

1 regions, which encompasses a lot of territory, France also had a good quarter and  
2 Germany delivered solid results as well. Central Europe, I should say. So we had a  
3 very balanced portfolio of performance on top of that. And by the way, I'm talking to  
you when I say that in local currency, and on top of that, UK and North and South  
Europe had extraordinary performance.

4 \*\*\*

5 Rahash Raju - Robert W. Baird - Analyst

6 Most of my questions have been answered, but maybe you could add a little more  
7 color on your performance in Asia and also performance by vertical markets.

8 Doug Smith - Mercury Interactive - EVP & CFO

9 Our performance in Asia, our Asia-Pac region, which is all of Asia excluding Japan,  
10 had significant over-achievement this quarter. We're just starting to build a business  
11 in Greater China. So we're really talking about the South Asian marketplace and  
12 Australia when we talk about that. We're just starting to build a presence in India  
13 when we talk about Asia as well. And Japan was -- we've had a management change  
14 in Japan we executed, and as a result there was a slight shortfall in business relative  
15 to our expectations. We have put our head of the Asia-Pac region, who has done a  
16 wonderful job of building that organization, in charge of running Japan as well,  
17 effective with the beginning of the year.

18 \*\*\*

19 48. Defendants' conference call of January 21, 2004 was false and misleading. First,  
20 although defendants provided actual 4Q03 and projected 1Q04 GAAP and non-GAAP financial  
21 results, those results were prone to error and manipulation, since defendants' internal controls  
22 and compliance practices were deficient and defective, to the extent that they would cause  
23 unprecedented auditing activities culminating in the disclosure of the "very likely" need to  
24 restate financial results over multiple quarters and years. Financial statements and guidance  
25 resulting from deficient and defective internal controls and compliance practices generally *fail to*  
26 *conform to generally accepted accounting practices* ("GAAP"), to the extent of the  
27 ineffectiveness of the Company's controls and practices.

28 49. Moreover, defendants sought to convince investors of reasons for optimism, that  
the Company could achieve their own aggressive guidance, based on new and confusing  
business metrics. Defendants sought to "connect" these metrics with their "new business", one  
that was far less susceptible to seasonality and far more geographically diverse. Finally,  
defendants built on this scheme to rally investors behind the notion that the Company was within

1 striking distance of a “triggering event” for its convertible notes. However, defendants’ efforts to  
2 “hype the business” lacked an objective basis and thus were false and misleading. Moreover,  
3 defendants concealed their deficient and defective internal controls and compliance practices.  
4 Thus, to the extent defendants’ deficient and defective internal controls and compliance practices  
5 resulted in violations of GAAP and false and misleading financial statements and guidance, the  
6 Company was at risk of SEC inquiry and investigation.

7 50. On July 21, 2004, the Company conducted a conference call to discuss Company  
8 earnings for 2Q04. Defendants stated in part:

9 Doug Smith - Mercury Interactive Corporation - Executive Vice President  
10 and CFO

11 Thanks, Amnon. Revenue for the quarter was a \$159 million, *an increase of*  
12 *35% as compared to Q2, 2003*. And approximately 3 percentage points of this  
13 increase is attributable to foreign exchange fluctuations as compared to the previous  
14 year. License and subscription revenues totaled \$94.6 million or 59% of total  
15 revenue.

16 As Amnon noted earlier we closed several million dollar plus deals, bundling  
17 all of our products, including IPG. This drove our percentage of subscription license  
18 business to 45% in Q2 from 41% in Q1, 2004, with nearly \$4 million of IPG licenses  
19 posted to deferred revenue.

20 Maintenance and professional services revenues totaled \$64.5 million or 41%  
21 of total revenue. The change in deferred revenue was \$26.2 million and our deferred  
22 revenue balance was \$327.3 million at the end of Q2. \$15.9 million of the increase in  
23 deferred revenue came from the growth of the subscription license balance.

24 The average length of our deferred revenue balance remains at 23 months. Of  
25 the total deferred revenue balance \$239.8 million was short-term deferred revenue  
26 and \$87.6 million was long-term deferred revenue. Total subscription licenses in  
27 deferred revenue, now equals \$172.8 million or 53% of total deferred revenue, which  
28 compares to \$157 million or 52% of total deferred revenue at the end of Q1 2004.

29 *As Amnon mentioned business across all geographies continues to be*  
30 *strong with all regions exceeding targets*. The America’s business accounted for  
31 62% of our business this quarter producing 10 of our 15 deals over \$1 million. Our  
32 partners provided approximately 39% of our new business in the quarter, which  
33 compares with 32% in Q1 2004.

34 Accenture was the major contributor to this increase and continues to help  
35 drive new business especially with ITG. Our ISB relationships continue to support  
36 our ongoing business as well, with our packaged applications business producing  
37 23% of product orders. As Amnon noted, custom applications using J2EE and .NET  
38 played a much stronger role in our growth this quarter. Moving down the P&L total  
39 non-GAAP spending for Q2 was a \$134.7 million as compared to \$130.4 million in  
40 Q1, 2004.

1 The increase is due to continued expansion of our organization and general  
2 corporate purposes. Our non-GAAP operating income was 24.3 million resulting in a  
3 15.3% operating margin. Other income in the quarter was \$3 million, net income was  
4 \$22 million, and pro forma diluted earnings per share was 22 cents as compared with  
5 the same number in Q2, 2003 and 24 cents in Q1, 2004.

6 We continued our investment in global field operations, increasing the  
7 number of sales teams around the world by 10 to 293 direct sales teams with 25  
8 dedicated to IT governance and 40 supporting our partners. In addition, we increased  
9 our corporate sales organization by 5 to 149 teams worldwide.

10 On to the balance sheet, the DSO's this quarter increased to 83 days as  
11 compared to 72 days in Q1, 2004. And approximately 15 days in DSO was  
12 attributable to the growth in our deferred revenues. We collected a 146% of our  
13 opening receivable balance and the balance over 90 days was approximately 4% for  
14 Q2. And finally, cash from operations this quarter totaled \$41.1 million.

15 ***Mercury continues to deliver superior productivity across the organization.  
16 Our non-GAAP operating margins were 15.3% in Q2. To better assess the progress  
17 and quality of our business model, I will again note the calculation of our  
18 operating efficiency ratio, which we use as a metric to assess our ongoing  
19 productivity.***

20 We measure total non-GAAP operating expenses, which were \$134.7million  
21 this quarter against the combination of our revenue and deferred revenue growth,  
22 which totaled \$185.3 million in Q2. Calculated on this basis, our operating efficiency  
23 ratio was 27.3%. In our GAAP financials we incurred stock-based compensation and  
24 amortization of intangibles of \$3.9 million, integration and other related charges of  
25 \$1.1 million and a gain on investments of \$400,000 and non-cash asset impairment  
26 charge of \$9.2 million related to Mercury's move and to its new headquarters in  
27 Mountain View, California.

28 The cash investments balance totaled \$1.4 billion at June 30, 2004 up \$58  
million from March 31, 2004. Our tax rate for Q2 was 19.5%. Although our tax rate  
may vary each quarter if viewed over a two to three-year period we expect our tax  
rate to average 20%.

Now on to guidance for the third quarter and the full year. Revenues are  
expected to be in the range of a \$160 million to \$170 million for the third quarter and  
\$665 million to \$685 million for the full year. Net increase in deferred revenue in Q3  
is expected to be in the range of \$20 million to \$30 million.

Non-GAAP operating margin is expected to be in the range of 15% to 17%  
for Q3 and we reiterate our 17% to 20% operating margin guidance for the full year.  
And GAAP diluted earnings per share is expected to be in the range of 16 to 21 cents  
for Q3 and in the range of 76 to 85 cents for the full year. And non-GAAP diluted  
earnings per share are expected to be in the range of 22 to 27 cents for Q3 and \$1.04  
to a \$1.12 for the full year.

This excludes approximately \$900,000 of integration and other related  
charges and \$4.2 million of stock-based compensation and amortization of  
intangibles as respects the third quarter. Fully diluted shares are expected to be in the  
range of 98 million to 99 million shares for both Q3 and the full year. Cash flows  
from operation is expected to be in the range of \$40 million to \$50 million for Q3  
and \$220 million to \$240 million for the full year.

1 One final note. The recently closed Appilog acquisition will result in one-  
2 time charges for in-process research and development in the range of approximately  
3 \$800,000 to \$1 million in the third quarter. Further there will be recurring quarterly  
4 amortization charges in the range of approximately \$500,000 to \$600,000. We now  
5 invite you to ask your questions.

6 QUESTION AND ANSWER

7 \*\*\*

8 Sarah Friar - Goldman Sachs - Analyst

9 ***Good morning, everyone. Doug, and Amnon just on the subscription  
10 license revenue side first, it fell in the quarter. I just want to understand how that  
11 could have come down on a quarter-over-quarter basis. I thought it would always  
12 build given how you recognize subscription revenue.***

13 Doug Smith - Mercury Interactive Corporation - Executive Vice President  
14 and CFO

15 It's probably a timing more of anything else, Sarah, when contracts are  
16 coming through the system. There is ***no accounting issue***. There is no economic  
17 issue. It's just a recognition of the contracts as they come through the system, you  
18 know, we've got thousands of contracts, some of them falling off, some of them  
19 coming on, so it has as much to do with what's going on two years ago as it does this  
20 quarter. There is really no other issue than that.

21 \*\*\*

22 Sarah Friar - Goldman Sachs - Analyst

23 ***OK. And then just if I might, on your guidance, your guidance show a lot  
24 of strength particularly in the back end in the fourth quarter of the year. I'm just  
25 wondering, what gives you that confidence? As you look at the pipeline and given  
26 everything we've seen in software this quarter not all of it a pleasant surprise, what  
27 gives you the confidence to kind of guide with such strength particularly in that  
28 final quarter? What's the visibility you really had there?***

Amnon Landan - Mercury Interactive Corporation - Chairman, President  
and CEO

We have enjoyed from a business standpoint a very, very strong quarter  
across the board. We have as strong a pipeline as any -- we have already closed a  
number of over \$1 million deals this quarter. And as I mentioned before, the value of  
what we have to our customers and our competitive position are getting better. And  
while I was well aware of what other vendors had talked about, the climate and the  
enterprise space at the end of the quarter, I must tell you that we had experienced a  
very robust environment. And, yes, the tail end of June people were difficult to deal  
with when you wanted to get large transactions done. But guess what? That's the  
nature of our - was always the nature of the business and will continue to be the  
nature of the business. People are spending money on the right things and we believe  
based on what we have done and our pipelines and forecasts that we should have a  
very, very strong second half.

1 \*\*\*

2 John Rizzuto - CS First Boston - Analyst

3 OK. And now specifically to the model and the stock, *you know clearly, the*  
4 *street doesn't seem to like today's numbers. I know even on the revenue and EPS it*  
5 *did come in near the low end of your range, maybe a little below.* What is, and of  
course deferred revenue beat -- well our estimates anyway. There is no consensus on  
deferred revenue growth I suppose.

6 What is -- I mean, I think this unexpected shifts from balance sheet  
7 improvement, a little bit weaker on the income statement or you know, we're going  
8 back and forth and that's creating some uncertainty which is I think impacting the  
9 stock here. What's the best way - better way we get better, you know, a quarter  
without an asterisk if you will, where we can say, hey, you know what business is  
good. We know that. But now let's get the expectations to the model so we can look  
at the stock price more effectively?

10 Doug Smith - Mercury Interactive Corporation - Executive Vice President  
and CFO

11 John, it's Doug. You know, first of all, obviously you're right. Our deferred  
12 revenue grew faster than we had guided to coming in at \$26 million, which obviously  
13 implies that we beat our bookings plan. That was what - that's a function of revenue  
14 plus change and deferred. What we've tried to suggest to you is that Q4 earnings per  
share are going to accelerate relative to the previous quarters.

15 \*\*\*

16 Gregg Moskowitz - Susquehanna Financial Group - Analyst

17 OK and then naturally there's been a lot of discussion on you know, whether  
FASB will require inclusion of contingent convertibles and GAAP earnings. So, I  
18 just wanted to get your thoughts on that, you know, as it pertains to Mercury?

19 Doug Smith - Mercury Interactive Corporation - Executive Vice President  
and CFO

20 Right, as we've been on the record saying that we would encourage Wall  
Street to look at our contingent convertible as equity and ultimately that's how we're  
21 going to treat it. In the short term, we continue to treat it as *debt by virtue of*  
22 *following the current FASB guidelines* and when we have the opportunity to treat it  
on an as converted basis we will.

23 \*\*\*

24 Tom Berquist - Smith Barney - Analyst

25 OK, and then finally Doug, just on the subscription side there has been some  
26 controversy in the industry about whether or not, if these were dollar or daily waiting  
there, daily accounting for the subscriptions or monthly accounting. How do you  
27 guys do it?

28 Doug Smith - Mercury Interactive Corporation - Executive Vice President  
and CFO

1                    *We account for our subscription revenue ratably in accordance with the*  
2 *contract terms generally using a daily methodology. We've always believed our*  
3 *subscription revenue accounting to be conservative. And we've reviewed our*  
4 *subscription accounting methodology with PricewaterhouseCoopers who is also*  
5 *our accountant and our audit committee and we are very comfortable that our*  
6 *subscription revenue accounting is in accordance with GAAP.*

7                    \*\*\*

8                    51. Defendants' conference call of July 21, 2004 was false and misleading. First,  
9 although defendants provided actual 2Q04 and projected 3Q04 GAAP and non-GAAP financial  
10 results, those results were prone to error and manipulation, since defendants' internal controls  
11 and compliance practices were deficient and defective, to the extent that they would cause  
12 unprecedented auditing activities culminating in the disclosure of the "very likely" need to  
13 restate financial results over multiple quarters and years. Financial statements and guidance  
14 resulting from deficient and defective internal controls and compliance practices generally *fail to*  
15 *conform to generally accepted accounting practices* ("GAAP"), to the extent of the  
16 ineffectiveness of the Company's controls and practices.

17                    52. Moreover, defendants dealt investors a significant disappointment based on a  
18 failure to achieve their own aggressive guidance and confusing business metrics. Defendants first  
19 shocked the market with the "disconnect" between subscription and revenue metrics. Then, in  
20 the midst of defendants' efforts to "guide up" into 4Q04, defendants assured analysts that there  
21 were "no accounting issues", that they were attentive to FASB guidelines and finally that the  
22 Company's auditors and audit committee were on top of any issues that could impact GAAP  
23 compliance. However, these "explicit assurances" were false and misleading, as defendants  
24 concealed their deficient and defective internal controls and compliance practices. Thus, to the  
25 extent defendants' deficient and defective internal controls and compliance practices resulted in  
26 violations of GAAP and false and misleading financial statements and guidance, the Company  
27 was at risk of SEC inquiry and investigation.

28                    53. On August 4, 2004, the Company filed SEC Form 424B, for Prospectus Supplement  
No. 5, for the offering of "Zero Coupon Senior Convertible Notes due 2008 and 9,673,050 Shares of  
Common Stock Issuable Upon Conversion of the Notes". The prospectus supplement undertook to

1 amend and restate in its entirety all information in the section of the Prospectus entitled “Selling  
2 Holders”. No other changes to the Prospectus were made, including any changes to information  
3 contained under the heading “Risk Factors”, regarding the Company’s accounting practices, internal  
4 controls or the “mix of information” regarding defendants’ business prospects on a quarterly basis.

5 54. Defendants’ registration statement/prospectus, as updated by the prospectus  
6 supplement of August 4, 2004 contained untrue, false and misleading statements of material fact or  
7 omitted to state a material fact required to be stated therein or necessary to make the facts stated  
8 therein not misleading, for the following reasons. First, on or before this date, defendants had  
9 employed an accounting scheme that failed to conform to generally accepted accounting practices. In  
10 particular, those practices and controls associated with compensation, including those related to  
11 stock options, were flawed and defective. To ultimately address the issues, a costly and burdensome  
12 external audit was required. Once completed, restatement of the Company’s financials over a two  
13 year period was “highly likely”. Defendants’ flawed and defective internal controls and corporate  
14 compliance issues were not disclosed as “Risk Factors” in the prospectus, or the registration  
15 statements and financial statements referenced within.

16 55. On October 20, 2004, the Company issued a press release entitled, “Mercury  
17 Interactive Corporation Reports Third Quarter Results - Revenue \$165.4 million; Increase of  
18 31% versus Q3 2003 - Net Increase in Deferred Revenue of \$19.3 million - Earnings Per Share:  
19 \$0.21 GAAP; \$0.27 Non-GAAP - Cash Flows from Operations: \$43.3 million”. The press  
20 release stated in part:

21 Mountain View, CA – October 20, 2004 – Mercury Interactive Corporation  
22 (NASDAQ: MERQ), the global leader in business technology optimization (BTO),  
today reported results for the third quarter ended September 30, 2004.

23 Revenue for the third quarter of 2004 was \$165.4 million, an increase of 31  
24 percent compared to \$126.1 million reported in the third quarter of 2003.

25 Deferred revenue for the third quarter of 2004 increased by \$19.3 million  
26 from the second quarter of 2004 to \$346.6 million. Cash generated from operations  
for the third quarter of 2004 was \$43.3 million compared to \$22.2 million in the third  
quarter of 2003.

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GAAP Results

Net income for the third quarter of 2004 was \$19.0 million, or \$0.21 per diluted share, compared to a net loss of \$6.7 million, or \$0.08 per diluted share, for the same period a year ago.

GAAP results for the third quarter include stock-based compensation and amortization of intangible assets of \$4.2 million, integration and other related charges of \$1.0 million, a one-time non-cash charge for in-process research and development of \$0.9 million, and a net loss on investments of \$0.5 million.

Non-GAAP Results

Net income for the third quarter of 2004 was \$24.4 million, or \$0.27 per diluted share, compared to \$21.3 million, or \$0.23 per diluted share, for the same period a year ago. Non-GAAP results, as presented in the attached reconciliation table, exclude the following recurring and non-recurring items: stock-based compensation and amortization of intangible assets, integration and other related charges, in-process research and development, a net loss on investments, and a non-cash excess facilities charge.

On July 1, 2004, Mercury completed its previously announced acquisition of Appilog for \$51.5 million in cash as well as assuming all of Appilog's outstanding options. This acquisition resulted in a one-time charge for in-process research and development of \$0.9 million and amortization of intangible assets of \$0.5 million, both of which are included in the previously mentioned GAAP results.

"We are very pleased with our strong results this quarter," said Amnon Landan, chairman and CEO at Mercury. "Mercury is in a large and growing market, customers are increasing their investments in our BTO offerings, and we continue to execute."

Stock Buyback

On July 28, 2004, Mercury announced that its board of directors had approved a new program to repurchase up to \$400 million of the company's common stock over the next two years. The specific timing and amount of repurchases will vary based on market conditions, securities law limitations and other factors. As of September 30, 2004, 9,675,000 shares had been repurchased for \$332.2 million, with an average all-in cost per share of \$34.33.

Financial Outlook

The following financial outlook is provided based on information as of October 20, 2004, and Management assumes no duty to update this guidance. Management provides the following guidance for the fourth quarter and full year ending December 31, 2004:

Revenue for the fourth quarter is expected to be in the range of \$185 million to \$195 million.

Net increase in deferred revenue for the fourth quarter is expected to be in the range of \$40 million to \$50 million.

1 Non-GAAP operating margin is reiterated for the full year to be in the range  
2 of 17 percent to 20 percent.

3 GAAP diluted earnings per share for the fourth quarter is expected to be in  
4 the range of \$0.28 to \$0.34.

5 Non-GAAP diluted earnings per share for the fourth quarter is expected to be  
6 in the range of \$0.32 to \$0.38. This excludes approximately \$300,000 of integration  
7 and other related charges and \$4.0 million of stock-based compensation and  
8 amortization of intangibles.

9 Fully diluted shares are expected to be in the range of 87.5 to 89.5 million for  
10 the fourth quarter and 93 to 95 million for the full year.

11 Cash flows from operations for the fourth quarter is expected to be in the  
12 range of \$60 million to \$70 million.

13 Non-GAAP guidance is adjusted from GAAP guidance by excluding the  
14 following recurring and non-recurring items: stock-based compensation and  
15 amortization of intangible assets, integration and other related charges, in-process  
16 research and development, a net loss on investments and a non-cash excess facilities  
17 charge.

18 Based on the recent issuance of EITF 04-08, "The Effect of Contingently  
19 Convertible Debt on Diluted Earnings per Share", beginning in the fourth quarter of  
20 2004 we will include 9,673,050 shares in our fourth quarter and full year weighted  
21 average share calculation. Our fourth quarter 2004 earnings per share guidance will  
22 be affected by this increase in shares on a GAAP and non-GAAP basis of \$0.03 to  
23 \$0.04. Our full year 2004 earnings per share guidance will be affected by this  
24 increase in shares on a GAAP basis of \$0.07 to \$0.08 and on a non-GAAP basis of  
25 \$0.10 to \$0.11.

26 \*\*\*

27 78. Defendants' press release of October 20, 2004 was false and misleading. First, although  
28 defendants provided actual 3Q04 and projected 4Q04 GAAP and non-GAAP financial results, those  
29 results were unreliable, since defendants' financial statements and guidance *actually failed to*  
30 *conform to generally accepted accounting practices* ("GAAP"). As the underlying cause of any  
31 failure to conform to GAAP rests with one or more defective and deficient elements of the  
32 Company's internal controls and compliance practices, the Company's financial statements and  
33 guidance were potentially prone to errors and manipulation, to the extent of the ineffectiveness of the  
34 Company's controls and practices. Finally, the extent of defendants' concealment of (i) deficient and  
35 defective internal controls and compliance practices, (ii) violations of GAAP and (iii) false and  
36 misleading financial statements and guidance would potentially subject the Company to SEC inquiry  
37 and investigation.

1           56.     On December 1, 2004, defendant Smith made a presentation to the NASDAQ 13th  
2 Investor Program. Defendant Smith stated in part:

3

4           Good afternoon, all. Thank you for your time. I will try to be efficient with  
5 the use of it.

6

7           We all know this; this is a first step in becoming Sarbanes-Oxley compliant.

8

9           And I think many of you may know that Mercury is currently positioning  
10 itself as the leader in so-called Business Technology Optimization. And I will take a  
11 couple of seconds. Well, what is business technology optimization all about? It's  
12 really about the shift in IT organizations going to running (technical difficulty) like a  
13 business. And I think (technical difficulty) time in the '80s when manufacturing-  
14 based companies realized that they had huge pockets of waste and inefficiency and  
15 drags on their profits coming about from their manufacturing organization. A  
16 manufacturing organization for a bank is its IT organization. And it's where the  
17 knowledge factory resides. And trying to optimize the value that that IT optimization  
18 creates is really the essence of what Business Technology Optimization is all about.

19

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20

21           (technical difficulty) Company for the better part of since 1994. During that  
22 intervening decade Mercury has grown at compound growth rate. If you did the  
23 CAGR on this it would be about 44 percent through 2004. We're pretty proud of that.  
24 The numbers in yellow, as you can see, refer to as we started to roll out our managed  
25 service business in 2000 and started selling our products on a subscription basis, first  
26 of all, in the application management business in 2000 -- 2000 we started selling our  
27 application management business as a subscription and our testing products we  
28 started selling -- excuse me, on a subscription basis. In 2003, we started creating a  
perpetual and deferred revenue model. And that's what those lines speak to, such that  
if you look at the numbers on the far right hand side, that reflects our Q4 guidance. It  
says the revenue will be somewhere in the range of 666 to 676, and that total change  
in deferred revenue for the year will be roughly 106 to 116 million of revenue.

29

30           The way to think about that is that's really a reflection enough what our new  
31 orders were during the course of the year. So when we get an quarter from a  
32 customer, we invoice that customer for that PO that we receive, and it either goes  
33 into the income statement as revenue or onto the balance sheet because it's a  
34 subscription or a maintenance order as deferred revenue. And that's what gives rise to  
35 that. So if you took the midpoint of that, that says that we are telling you we think  
36 we're going to do somewhere in the range of \$780 million or so in new orders this  
37 year, which compares to roughly 625 a year ago, which is roughly a 25 percent year-  
38 over-year growth rate in terms of new orders, and some of that going to the income  
statement and the balance sheet.

39

40           Some of the other facts I think we already heard in introduction about  
41 Mercury. We do still have \$1.1 billion in cash, even though we bought back roughly  
42 \$332 million of our stock in the third quarter when the stock took a big hit and went  
43 down to around -- I think we were able to buy it at \$34. I hope some of you could  
44 too.

45

46

1 Selling model -- starting to shift; critical to continuing that business moving  
2 forward from 780 million to \$1 billion. That would be sort of the ambition that we  
3 have as we going into 2005 and beyond. What we started in 2003 was to introduce  
4 the notion of a strategic account manager. That's somebody who is responsible for 1,  
5 2 or 3 key accounts and really developing the whole account in its entirety, whether  
6 that be IT governance or -- I don't know if this is supposed to -- there it is. Whether it  
7 be IT governance, application delivery or application management, the point is there  
8 are strategic account managers sell all of our products to these strategic accounts.  
9 They have fairly substantial quotas. And we had 10 of them around the world in  
10 2003. We have roughly 40 of them in the field actively in 2004. And we expect that  
11 we will have a significantly larger number of them in the 2005. And clearly the  
12 whole idea of these guys is to kind of go after Mercury's what we call mile wide and  
13 inch deep customer base. We have got 20,000 customers; 19,500 of them know that  
14 they're customers of ours and the rest of them we have to sort of make sure they  
15 know -- become customers of ours. It's really trying to penetrate more deeply those  
16 customers with that suite of products.

17 \*\*\*

18 Let me tell you that on the revenue side of things here -- we have an  
19 incredible amount of data on our website, www.mercury.com. You'll see everything  
20 there is about this presentation, about other presentations, all of our financials, 12  
21 quarters worth of data at the line item level by business, by geography. ***It's all there  
22 for you. It is a very significant supplemental section. We kind of try to do the best  
23 job we can to make as much of our data transparent as possible. Just go to the  
24 company information page, go to the IR section, and it's all there -- all the taped  
25 earnings calls and stuff like that.*** I would point out that Amnon does from time to  
26 time do keynote speeches. He's doing 1 tomorrow as well. That will be on the Web.  
27 And presumably the presentation that we saw today or variations of it are also on the  
28 Web.

29 I will leave you with the thought that Mercury is a 25 percent plus growth  
30 company. That's how it's going to grow, by driving further penetration of the testing  
31 business into making testing a more strategic part of the solution that the IT  
32 organization uses to deliver quality performance and reliability to their business  
33 partners. I think we talked at length about the IT governance business today and the  
34 fact that there's a strategic shift to distributed Web-based applications is opening a  
35 huge opportunity for Mercury in the system management business is what gives rise  
36 to our growing 40 percent plus in the application management business.

37 \*\*\*

38 57. The presentation of defendant Smith on December 1, 2004 was false and misleading.  
39 Despite his claims regarding the "transparency" of the Company's reporting practices, defendant  
40 Smith already knew that the SEC had already opened an informal inquiry in November 2004, into  
41 the Company's accounting practices and internal controls, as they related to compensation issues,  
42 including stock options. For this reason alone, defendant Smith knew that the accuracy of the  
43 Company's financial reports was subject to the uncertainties and issues presented by the SEC  
44 inquiry, including the potential for financial restatements, for one or more quarters. Moreover, since

1 these SEC issues actually occurred at an earlier time, market knowledge of the inquiry would  
2 adversely impact sales of the Company's convertible notes. Rather than admit to analysts that the  
3 Company was now the subject of SEC scrutiny and that the costs to address these issues could be  
4 significant, defendant Smith concealed his knowledge of the issues, choosing instead to discuss the  
5 Company's prospects for continued growth.

6 58. On December 2, 2004, defendant Landan made a presentation to the Mercury at  
7 Credit Suisse First Boston Technology Conference. Defendant Landan stated in part:

8

9 Amnon Landan - Mercury Interactive - Chairman & CEO

10 Thank you, John. Good afternoon. Hopefully you enjoyed lunch. So I'm going to talk  
11 a little bit more about what we see happening in the industry overall, what are the  
12 drivers that in my mind influence how IT organizations are going about their  
13 business, where they spend their money. Clearly all of those have a lot of impact on  
14 Mercury. And then spend some time on connecting the dots -- how this impacts us.  
15 And then I'll tell you what our bookings are for Q4 year-to-date.

13

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14

15 Governance and compliance -- Sarbanes-Oxley and (indiscernible) and Basel II. And  
16 then all the nice internal things like Six-Sigma and ISO and CMN (ph) and ITIL and  
17 all the other good stuff is putting a significant burden on organizations. And the  
18 numbers are fairly significant. This year, \$5.5 billion spent on SOX; 4 billion spent  
19 in Europe on Basel II. But it's actually way beyond those numbers.

17

18 And if I look at Mercury's sales, *as we are now in the home stretch of becoming*  
19 *SOX compliant*, all of my IT organizations, all of my finance organizations are doing  
20 two shifts a day. They have a day job and they have a SOX job. And I'm not  
21 exaggerating. And it's the same in many, many other companies. This forces a totally  
22 different approach and discipline on IT organizations. Right now, everyone is trying  
23 to patch it. But next year, organizations are going to take a much more methodical  
24 (indiscernible) way to deal with these compliance demands. Because all these  
25 compliance requests end up being around governing IT. As we said before, the IT is  
26 the business, so on and so forth. So all these regulations end up into make sure that  
27 you control the environments and the processes that you have in your IT and  
28 technology environment. I think next year, the notion of governance and specifically  
compliance is going to be a key, key driver for the growth of our IT governance  
business.

24

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25

Moderator

26

27 I know you mentioned large deals, so I just want to follow up. And I know you don't  
28 want to give any projections today. But do you expect this large deal trend that  
you've experienced better than any company in my coverage universe, which is

1 pretty broad, do you expect that to continue? I mean would that be something that we  
2 would look at and expect to see these large deals continue to accelerate?

3 Amnon Landan - Mercury Interactive - Chairman & CEO

4 There was a real transition over the last six quarters. We used to have two to four  
5 deals over \$1 million every quarter. Now we have 60 to 20 over the last few quarters.  
6 Yes, this trend should continue. And frankly, one of the things that we should do is to  
7 balance and we'll continue to have a transaction of business on one hand. And to that  
8 extent, we are investing heavily in our corporate sales organization and they are  
9 doing an amazing job in servicing -- not necessarily the low end of the market, but  
10 the additional sales into the customer base. And at the same time, extending the high-  
11 end channel, which is the strategic account managers. And often going into next  
12 years to continue and extend on those two fronts. And as a result, I believe we  
13 continue -- we should continue and see a large number of bigger deals.

14 \*\*\*

15 59. The presentation of defendant Landan on December 1, 2004 was false and  
16 misleading. Despite his claims that the Company was "*in the home stretch of becoming SOX*  
17 *compliant*", defendant Landan already knew and concealed that the SEC had opened an informal  
18 inquiry in November 2004, into the Company's accounting practices and internal controls, as they  
19 related to compensation issues, including stock options. For this reason alone, defendant Landan  
20 knew that the accuracy of the Company's financial reports was subject to the uncertainties and issues  
21 presented by the SEC inquiry, including the potential for financial restatements, for one or more  
22 quarters. Moreover, since these SEC issues actually occurred at an earlier time, any market  
23 knowledge of the inquiry would adversely impact sales of the Company's convertible notes. Rather  
24 than admit to analysts that the Company was now the subject of SEC scrutiny and that the costs to  
25 address these issues could be significant, defendant Landan also concealed his knowledge of the  
26 issues, choosing instead to discuss the Company's prospects for continued growth.

27 60. On December 2, 2004, the Company filed SEC Form 424B, for its Prospectus  
28 Supplement for the offering of "Zero Coupon Senior Convertible Notes due 2008 and 9,673,050  
Shares of Common Stock Issuable Upon Conversion of the Notes". The prospectus supplement  
undertook to amend and restate in its entirety all information in the section of the Prospectus entitled  
"Selling Holders". No other changes to the Prospectus were made, including any changes to  
information contained under the heading "Risk Factors", regarding the Company's accounting

1 practices, internal controls or the “mix of information” regarding defendants’ business prospects on a  
2 quarterly basis.

3 61. Defendants’ registration statement/prospectus, as updated by the prospectus  
4 supplement of December 2, 2004 contained untrue, false and misleading statements of material fact  
5 or omissions of material facts required to be stated therein or necessary to make the facts stated  
6 therein not misleading, for the following reasons. Defendants already knew that the SEC had already  
7 opened an informal inquiry in November 2004, into the Company’s accounting practices and internal  
8 controls, as they related to compensation issues, including stock options. Moreover, defendants knew  
9 that the accuracy of the Company’s financial reports was subject to the uncertainties and issues  
10 presented by the SEC inquiry, including the potential for financial restatements, for one or more  
11 quarters. None of these “Risk Factors”, pointing to defendants’ concealment of its wayward  
12 accounting scheme, questionable internal controls and the SEC inquiry into these matters were  
13 included as an update to defendant’s prospectus.

14 62. On December 21, 2004, the Company filed SEC Form 424B, for Prospectus  
15 Supplement for the offering of “Zero Coupon Senior Convertible Notes due 2008 and 9,673,050  
16 Shares of Common Stock Issuable Upon Conversion of the Notes”. The prospectus supplement  
17 undertook to amend and restate in its entirety all information in the section of the Prospectus entitled  
18 “Selling Holders”. No other changes to the Prospectus were made, including any changes to  
19 information contained under the heading “Risk Factors”, regarding the Company’s accounting  
20 practices, internal controls or the “mix of information” regarding defendants’ business prospects on a  
21 quarterly basis.

22 63. Defendants’ registration statement/prospectus, as updated by the prospectus  
23 supplement of December 21, 2004 contained untrue, false and misleading statements of material fact  
24 or omissions of material facts required to be stated therein or necessary to make the facts stated  
25 therein not misleading, for the following reasons. Defendants already knew that the SEC had already  
26 opened an informal inquiry in November 2004, into the Company’s accounting practices and internal  
27 controls, as they related to compensation issues, including stock options. Moreover, defendants knew  
28 that the accuracy of the Company’s financial reports was subject to the uncertainties and issues

1 presented by the SEC inquiry, including the potential for financial restatements, for one or more  
2 quarters. None of these “Risk Factors”, pointing to defendants’ concealment of its wayward  
3 accounting scheme, questionable internal controls and the SEC inquiry into these matters were  
4 included as an update to defendant’s prospectus.

5 64. On January 24, 2005, the Company issued a press release entitled, “Mercury  
6 Interactive Corporation Reports Preliminary Fourth Quarter Results - Increasing Revenue and  
7 Earnings Estimates”. The press release stated in part:

8  
9 Mercury Interactive Corporation (NASDAQ: MERQ), the global leader in  
10 business technology optimization (BTO), today announced preliminary financial  
11 results for the fourth quarter ended December 31, 2004.

12 Mercury expects total revenue for the fourth quarter of 2004 to be in the  
13 range of \$203 million to \$205 million, which exceeds previously provided guidance  
14 of \$185 million to \$195 million. The increase in deferred revenue for the fourth  
15 quarter of 2004 is expected to be in the range of \$63 million to \$66 million, which  
16 exceeds previously provided guidance of \$40 million to \$50 million.

17 GAAP diluted earnings per share for the fourth quarter of 2004 is expected to  
18 be in the range of \$0.34 to \$0.36. Non-GAAP diluted earnings per share for the  
19 fourth quarter of 2004 is expected to be in the range of \$0.40 to \$0.42. In both GAAP  
20 and Non-GAAP diluted earnings per share estimations, fully diluted shares were  
21 approximated in the range of 97.7 million to 98.7 million, which takes into  
22 consideration the recent issuance of EITF 04-08, “Effect of Contingently Convertible  
23 Debt on Diluted Earnings per Share”. Mercury’s previously provided guidance of  
24 GAAP diluted earnings per share of \$0.28 to \$0.34 and Non-GAAP diluted earnings  
25 per share of \$0.32 to \$0.38 were both expected to be reduced by \$0.03 to \$0.04, due  
26 to the inclusion of the EITF.

27 Non-GAAP results for the fourth quarter of 2004 exclude stock-based  
28 compensation and amortization of intangibles and integration and other acquisition  
related charges in the range of \$4.1 million to \$4.4 million, a non-cash adjustment to  
excess facility charge of approximately \$0.2 million and net gain on investments of  
approximately \$0.1 million.

*Mercury cautions that these results are preliminary, based on the  
information currently available, and are subject to the closing of its books and  
completion of its accounting procedures and determination of final accounting  
adjustments.*

“We are very pleased with our strong performance in the fourth quarter and  
full year 2004,” said Amnon Landan, chairman and CEO at Mercury. “We would  
like to thank our customers and partners for their continued investment in Mercury’s  
BTO offerings.

\*\*\*



1 Doug Smith - Mercury Interactive Corporation - EVP & CFO

2 Thanks, Amnon. Revenue for the quarter was \$204.3 million, an increase of 34  
3 percent as compared to Q4 2003. Approximately 4 percentage points of this increase  
4 were attributable to foreign exchange fluctuations as compared with the previous  
5 year. License and subscription revenues totaled \$128 million, 63 percent of total  
6 revenue. Maintenance and professional services revenues totaled \$76.3 million, 37  
7 percent of total revenue.

8 *Looking out over our geographies, the Americas accounted for 61 percent of our*  
9 *revenues; Europe, Middle East, and Africa 31 percent, and Japan and Asia*  
10 *contributing 8 percent. Revenue for the year ended December 31, 2004, was \$685.5*  
11 *million, an increase of 35 percent when compared to the year ended December 31,*  
12 *2003. The change in deferred revenue was \$67.7 million for the quarter, bringing*  
13 *the deferred revenue balance to \$414.3 million. Of the increase, \$24.9 million*  
14 *came from the net growth of subscription license balances. The dollar weighted*  
15 *average length of our subscription revenue balance remains roughly flat at 22*  
16 *months.*

17 \*\*\*

18 Now on to guidance for the first-quarter 2005. Revenue for the first quarter is  
19 expected to be in the range of \$190 million to \$200 million. Net increase in deferred  
20 revenue for the quarter is expected to be in the range of 5 to \$15 million. GAAP  
21 diluted earnings per share for the first quarter is expected to be in the range of \$0.26  
22 to \$0.32. Non-GAAP diluted earnings per share for the third quarter -- excuse me, for  
23 the first quarter -- is expected to be in the range of \$0.28 to \$0.34.

24 Fully diluted shares outstanding for this quarter is expected to be in the range of 98  
25 million to 100 million shares, which takes into consideration the recent issuance of  
26 EITF '04-'08, effective contingently convertible debt on diluted earnings per share.  
27 Non-GAAP guidance for first-quarter of 2005 is adjusted from GAAP guidance by  
28 excluding stock-based and amortization of intangible assets of \$4 million, and a gain  
on sale of our [Idol] building of approximately \$300,000.

Guidance for the full-year of 2005. New order growth, revenue plus change in  
deferred revenue, for the full year is expected to be in the range of 20 to 25 percent.  
Revenue growth for the full year is expected to be in the range of 28 to 32 percent.  
Non-GAAP operating margins for the full year are expected to be in the range of 20  
to 21 percent. GAAP diluted earnings per share for the full year is expected to be in  
the range of \$1.36 to \$1.46, and non-GAAP diluted earnings per share for the full  
year are expected to be in the range of \$1.45 to \$1.55.

Lastly, cash flow from operation also grow in the range of 25 to 30 percent. Non-  
GAAP guidance for the full year is adjusted from GAAP guidance by excluding  
stock-based compensation and amortization of intangible assets of \$15.8 million, and  
a gain on the sale of our Idol building of approximately 300,000 dollars. Lastly, I  
want to remind you that a detailed Q4 2004 earnings presentation and supplemental  
schedules are available on the main investor relations page of the Company's  
website. We now invite you to ask your questions.

\*\*\*

Gregg Moskowitz - Susquehanna Financial Group - Analyst

1 Okay. Thank you. And I will add my congratulations. Looking across the regions,  
2 obviously, there was pretty good strength across the board. Europe did seem to look -  
3 - did seem to show the biggest improvement, sequentially. I know you have struggled  
4 previously in Central Europe. Maybe you could just talk a little bit about what you  
5 saw in Europe this quarter, and Central Europe, specifically.

6 Amnon Landan - Mercury Interactive Corporation - Chairman & CEO

7 *Europe was our star in Q4. We did good on all regions, we did great in many of*  
8 *the regions, but Europe, they had a hell of a performance, even when you back out*  
9 *the currency impact. They had a break-up quarter in local currencies and*  
10 *specifically to your question, in Central Europe, we brought in a new leader to*  
11 *round that territory a few months ago and we had better-than-expected*  
12 *performance and are very optimistic about our future in that part of the globe.*

13 \*\*\*

14 67. Defendants' report and comments during the conference call of February 2, 2005 was  
15 false and misleading for the following reasons. First, defendants already knew that the SEC had  
16 already opened an informal inquiry in November 2004, into the Company's accounting practices and  
17 internal controls, as they related to compensation issues, including stock options. For this reason  
18 alone, defendants knew that the accuracy of the Company's financial reports was subject to the  
19 uncertainties and issues presented by the SEC inquiry, including the potential for financial  
20 restatements, for one or more quarters. Moreover, the issues behind the SEC inquiry actually  
21 occurred prior to November 2004, any market knowledge of the inquiry would adversely impact  
22 sales of the Company's convertible notes. Rather than admit to analysts that the Company was now  
23 the subject of SEC scrutiny and that the costs to address these issues could be significant, defendants  
24 concealed their knowledge of the issues, choosing instead to issue aggressive guidance for continued  
25 growth.

26 68. On March 9, 2005, defendant Smith addressed the Lehman Brothers Global Software,  
27 IT Services & Internet Conference. Defendant Smith stated in part:

28 Good morning, everyone. I suppose this will probably be fairly straightforward for  
29 many of view, as I look across the room. *At one level it kind of is indicative of the*  
30 *fact that we haven't felt compelled to need to change very much, because clearly*  
31 *our focus has been on the fact that technology has been at the centerpiece of*  
32 *change in the business of many of the financial services companies, retail,*  
33 *pharmaceutical companies, and telecom service providers around the world. It has*  
34 *been a very beneficial place to be for Mercury over the last several quarters.*

1 We believe there is a set of directional activities that are going on that are just merely  
2 accelerating these trends. So our job is to really ride these waves and maximize the  
3 opportunity that is in front of us that we have yet to really capitalize on.

3 \*\*\*

4 Lastly and one that has really shown up more in the course of 2004, is the overall  
5 focus on managing IT like a business and addressing to the compliance challenges  
6 that IT organizations, as well as finance organizations, have encountered, as the  
7 world of compliance is becoming increasingly demanding and an increasingly  
8 demanding world, as well as one taking on a much higher priority and focus for both  
9 the chief information officer as well as the chief financial officer, not to mention all  
10 of the executive officers of the company. ***Just finishing up my SOX compliance  
11 process this week. So we can spend a minute talking about that later.***

8 \*\*\*

9 On the compliance and governance side, I know Mercury just spent several million  
10 dollars. We estimated that we spent over 14,000 hours internally, direct, with all the  
11 people in accounting and finance and IT and HR over the last six months. We have  
12 hope successfully implementing our 404 compliance activities, documenting over  
13 900 controls that run our business. You just take that and explode that around the  
14 world and it is obviously a huge effort to overcome. Those 14,000 hours had to  
15 come, for example, from people who all had day jobs as well.

13 So the impact I believe on most finance and IT organizations around the world was  
14 significant. I think what we realized as we were doing it, and I suspect many other  
15 companies, is that driving a compliance project is not unlike driving an IT project.  
16 ***That when you get these changes in regulations, when you get these changes in  
17 policies, whether that be banking regulations, pharmaceutical regulations, or SEC  
18 regulations in the case of 404 SOX, you have to both -- it causes you to impact your  
19 business and it causes you to not only document your business processes, but  
20 frankly change many of them in order to assure that you're going to be able to  
21 meet the regulations that are in place.***

18 \*\*\*

19 I think for most of the people in this room, they know that Mercury has been an up  
20 and to the right company for many years now, 2004 being yet another one, where we  
21 delivered at \$686 million of revenue and added another \$134 million to our balance  
22 sheet in the form of deferred revenue. ***We are certainly giving you a sense that in  
23 2005 we're going to be able to continue this sustained growth that would have us  
24 moving in the direction of \$1 billion. This was the guidance that we provided in  
25 January; and obviously I wouldn't be putting it up here if I didn't think we were  
26 going to do it.***

24 We're being very -- relative to the last two years, as the comparables get more  
25 challenging and the numbers get bigger, the laws of the math works, we're basically  
26 giving you our conservative view of where we see the business growing from a new  
27 order standpoint. Revenue growth and new order growth, clearly, while net revenue  
28 growth exceeds new order growth, what I would tell you is that when you look at the  
fact that we have got \$300 million of business sitting on short-term deferred revenue,  
and you look at the yield that we got from our bookings in 2004, that became  
current-quarter revenue -- and you should be able to figure all that out -- if you just  
extend that forward into 2005, and you add that to the \$312 million, you would not

1 be surprised to find out that revenue is growing faster than bookings in the model  
2 that we have got here.

3 *As revenue grows faster, then P&L margins, so-called operating margins, will*  
4 *improve in 2005 -- that is evidenced in the guidance we gave of 20 to 21% --and*  
5 *correspondingly have an impact on our earnings going from \$1.09 to the range*  
6 *that we are offering you now of \$1.45 to \$1.55. As we catch up on some working*  
7 *capital movements that we had in 2004, we didn't collect as much in the U.S. as we*  
8 *had historically from a percentage balance and over 90 (ph) standpoint, we think*  
9 *we ought to get some benefit of that back in 2005 with the management changes*  
10 *and the focus changes we have made in the U.S. collections team; and as a result*  
11 *see cash flows grow a little faster than bookings as well.*

12 I just want to make sure at the end of this that I remind you that in 2005 we will  
13 continue to be investing in building our business, as we grow out our strategic  
14 account management groups; as we look to build out our relationships with our  
15 partners around the world; as we look to become more aggressive, investing in the  
16 continent of Europe and in Asia, in particular in China and India. With Tony Zingale,  
17 our President and Chief Operating Officer, on board we feel very optimistic that we  
18 can realize some significant benefits from those investments as we move forward  
19 beyond that.

20 We are accelerating our R&D investment in application management as we look at  
21 the changed management market and leverage our Appilog business that we acquired  
22 in 2004. As we double down on the ITG business in 2005 that we began to build.  
23 And lastly I will remind you that we are spending a lot of R&D money and focus on  
24 helping to integrate the Optimization Centers so that we can deliver these as more  
25 integrated solutions to our customers, and that is what they have been asking of us  
26 for.

27 *Of course, we are seeking to build out the management team and invest in people*  
28 *around the country. I think we added roughly 350 people in 2004, and I would not*  
29 *be surprised if we continue to invest at that level in 2005. No tuck-ins are currently*  
30 *sitting in my pocket to tuck in, but we will continue to look at areas where we can*  
31 *enhance our capabilities in IT Governance, application management, and our*  
32 *application delivery business. We explore the number of partnerships in that*  
33 *direction.*

34 \*\*\*

35 69. Defendant Smith's remarks of March 9, 2005 were false and misleading for the  
36 following reasons. First, defendant Smith already knew that the SEC had already opened an informal  
37 inquiry in November 2004, into the Company's accounting practices and internal controls, as they  
38 related to compensation issues, including stock options. ***Incredibly, defendant Smith pointed out***  
39 ***that his SOX compliance process would be completed by week's end.*** This highly deceptive, false  
40 and misleading remark pointed to the lack compliance issues at the Company, at a time when the  
41 Company continued to deal with audit and compliance activities triggered by the SEC inquiry.  
42 Defendant Smith knew that the accuracy of the Company's financial reports was subject to the

1 uncertainties and issues presented by the SEC inquiry, including the potential for financial  
2 restatements, for one or more quarters. Moreover, he knew that the issues behind the SEC inquiry  
3 actually occurred prior to November 2004, and that any market knowledge of the inquiry would  
4 adversely impact sales of the Company's convertible notes. Rather than admit to that the Company  
5 was now the subject of SEC scrutiny and that the costs to address these issues could be significant,  
6 defendant Smith concealed their knowledge of the issues, choosing instead to issue aggressive  
7 guidance for continued growth.

8         70.       Moreover, as CFO, defendant Smith was in a position to know firsthand if the  
9 Company was slipping against its ambitious goals and aggressive guidance. Smith reiterated this  
10 guidance during his March 9, 2005 address, stating that the Company was moving in the direction of  
11 \$1 billion in revenues for 2005. Defendant Smith added, "[t]his was the guidance that we provided in  
12 January; and obviously I wouldn't be putting it up here if I didn't think we were going to do it".  
13 Nevertheless, these comments stand in stark contrast with the fact that defendants undertook many  
14 months of review of their business operations, a review that could reasonably trigger restructuring  
15 costs during the second half of 2005,<sup>5</sup> predicated on defendants' knowledge of trends and business  
16 progress that could not have supported a \$1 billion revenue number for 2005.

17         71.       On April 28, 2005, defendants issued a press release entitled, "Mercury Interactive  
18 Corporation Reports First Quarter Results - Revenue of \$198.8 million for the quarter; Growth of  
19 27% versus Q1 2004 - Net Increase in Deferred Revenue of \$2.6M - Earnings Per Share: \$0.32  
20 GAAP; \$0.34 Non-GAAP - Cash Flows from Operations: \$72.1 million". The press release stated in  
21 part:

22  
23               Mercury Interactive Corporation (NASDAQ: MERQ), the global leader in business  
24               technology optimization (BTO), today announced financial results for the first  
              quarter ended March 31, 2005.

25               Revenue for the first quarter of 2005 was \$198.8 million, an increase of 27 percent  
26               compared to \$156.8 million reported in the first quarter of 2004.

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27  
28 <sup>5</sup>       See ¶ 89.

1 Deferred revenue for the first quarter of 2005 increased by \$2.6 million from the  
2 fourth quarter of 2004 to \$417.0 million. Cash generated from operations for the first  
3 quarter of 2005 was \$72.1 million compared to \$62.0 million in the first quarter of  
4 2004.

5 "Q1 was a strong start for the year," said Amnon Landan, CEO at Mercury.  
6 "Customers continue to invest in our solutions and leverage our broad and flexible  
7 portfolio of BTO offerings."

#### 8 GAAP Results

9 Net income for the first quarter of 2005 was \$31.4 million, or \$0.32 per diluted share,  
10 compared to \$18.9 million, or \$0.18 per diluted share, for the same period a year ago.

11 Diluted earnings per share was calculated taking into consideration the recent  
12 issuance of EITF 04-08, "Effect of Contingently Convertible Debt on Diluted  
13 Earnings per Share." Net income was adjusted for debt related costs on an 'as if'  
14 converted basis by \$0.4 million for the quarter. Fully diluted shares were 99.4 million  
15 shares for the quarter ended March 31, 2005. Previously reported net income and  
16 diluted earnings per share for the first quarter ended March 31, 2004 have also been  
17 restated based on the effect of EITF 04-08.

#### 18 Non-GAAP Results

19 Non-GAAP net income for the first quarter of 2005 was \$33.8 million, or \$0.34 per  
20 diluted share, compared to \$23.8 million, or \$0.22 per diluted share, for the same  
21 period a year ago. Non-GAAP results for the first quarter of 2005, as presented in the  
22 attached reconciliation table, exclude the following items: stock-based compensation  
23 and amortization of intangibles related primarily to previous acquisitions of \$4.0  
24 million; a gain on a sale of a vacant facility of \$0.3 million; a gain on investment of  
25 \$1.0 million; a net loss on investments in non-consolidated companies and warrant of  
26 \$0.3 million; and related tax effect of the items above.

27 Based on the effect of EITF 04-08, non-GAAP net income and fully diluted shares  
28 were also adjusted in the calculation of diluted earnings per share by the same  
amounts GAAP diluted earnings per share were adjusted. In addition, previously  
reported non-GAAP net income and diluted earnings per share for the first quarter  
ended March 31, 2004 have been restated.

#### Financial Outlook

The following financial outlook is provided based on information as of April 20,  
2005 and management assumes no duty to update this guidance.

Management provides the following guidance for the second quarter of 2005:

Revenue for the second quarter is expected to be in the range of \$205 million to \$215  
million;

Net increase in deferred revenue for the second quarter is expected to be in the range  
of \$20 million to \$30 million;

GAAP diluted earnings per share for the second quarter is expected to be in the range  
of \$0.30 to \$0.34;

1 Non-GAAP diluted earnings per share for the second quarter is expected to be in the  
2 range of \$0.33 to \$0.37; and

3 Fully diluted shares outstanding for the second quarter is expected to be in the range  
4 of 99 million to 101 million, which takes into consideration the issuance of EITF 04-  
5 08, "Effect of Contingently Convertible Debt on Diluted Earnings per Share."

6 Non-GAAP guidance for the second quarter of 2005 is adjusted from GAAP  
7 guidance by excluding stock-based compensation and amortization of intangible  
8 assets related primarily to previous acquisitions of \$3.9 million.

9 ***Management reiterates the full year 2005 guidance as provided on February 2,  
10 2005, except that it increases the following full year 2005 guidance:***

11 ***GAAP diluted earnings per share for the full year is expected to be in the range of  
12 \$1.41 to \$1.48***

13 ***Non-GAAP diluted earnings per share for the full year is expected to be in the  
14 range of \$1.50 to \$1.57***

15 ***Non-GAAP guidance for 2005 is adjusted from GAAP guidance to exclude the  
16 following items: stock-based compensation and amortization of intangible assets  
17 related primarily to previous acquisitions of \$15.8 million, a gain on investments of  
18 \$1.0 million, a net loss on investment in non-consolidated companies and warrant  
19 of \$0.3 million and a gain on a sale of vacant facilities of \$0.3 million; and related  
20 tax effect of the items above.***

21 72. Defendants' press release of April 28, 2005 was false and misleading for the  
22 following reasons. First, defendants continued to actively conceal compliance issues at the  
23 Company, at a time when the Company continued to deal with audit and compliance activities  
24 triggered by the SEC inquiry. Secondly, and more importantly, defendants hyped their business by  
25 making the deliberate decision to raise guidance for 2005, in spite of the fact that revenue was down  
26 more ***than 2% or \$5.5 million versus the prior quarter***. Thus, not only was defendants' decision to  
27 increase guidance an absolutely incredible development, defendants provided ***no objective basis  
28 whatsoever for increasing their guidance for 2005.***<sup>6</sup> If anything, the Company's lackluster  
performance for 1Q05 signaled the beginning of ***pretty bleak picture*** for Mercury Interactive and  
other enterprise software vendors.

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25 <sup>6</sup> On May 2, 2005 and then again on May 12, 2005, defendants filed SEC Form POS AM, to  
26 deregister a \$113,885,000 aggregate principal amount of the Zero Coupon Senior Convertible Notes  
27 due 2008 (including the underlying 2,203,231 shares of common stock) which remained unsold by  
28

1 **THE TRUTH IS REVEALED**

2 73. On May 16, 2005, defendant Landan addressed the JPMorgan 33rd Annual  
3 Technology Conference, to seeking to convince analysts why they *ought to ignore reality and*  
4 *adopt a bullish view of Company's prospects and incredible 2005 guidance*, stating in part:

5  
6 So the key question is Mercury was so far clearly a growth company. Why should it  
7 continue to be a growth company and *when the backdrop around enterprise*  
8 *software is pretty bleak and clearly Q1 was yet another kind of a wakeup call on*  
9 *the heels of Q2 of last year*. And the short version is the following. Where I started  
10 with the premise that IT organizations are going to restructure themselves, all of  
11 them between now and five to seven years down the road. If you don't buy into this  
12 thesis. then probably we are a bad investment. We do buy into this. We believe in it.  
13 We see this on a daily basis.

14 *As they grow through this transformation we look at every one of our lines of*  
15 *business, and we only see is an unlimited upside*. On the application delivery, on the  
16 testing side, already talked about us growing, the Indian offshore growing, people are  
17 taking a more strategic approach to quality of performance using centers of  
18 excellence and the fact that the vast majority of the applications are still not being  
19 tested and they will be tested because they are all interconnected, and that is the key  
20 issue here. You can no longer say these three applications are more business critical  
21 and I'll ignore the others. They all connect, they all share data. And as we move into  
22 more advanced technologies like service oriented architectures its going to be even  
23 worse.

24 On the application management we are in the beginning of a cycle where people are  
25 moving away from infrastructure management to application management to assure  
26 business continuity. A small fraction of the market have made the leap. the whole  
27 market is yet to follow; everyone now is of the opinion that they will. We are in the  
28 driver seat on that one. And IT governance again that is kind of the linchpin of this  
whole transformation, and it is not even in the first inning. We're still in spring  
training with that one. And what IDC Mercury's BTO message is in tune with the top  
of mind issues facing IT executives today and I am almost done.

29 Few financial highlights, Q1, we had a good Q1. No one said great quarter in Q1 in  
30 the (indiscernible) hall, maybe everyone was still hanging (ph) over from all the  
31 misses, but we thought we had a good quarter. *Revenues close to \$200 million*  
32 *growing 27%. EPS grew 55%*. Record number of deals over \$1 million, just four, six  
33 quarters ago we used to have a handful of those deals. We had 19 and the average  
34 deal size is growing significantly. We are successful in enterprising Mercury. It is  
35 still a small part of our overall business, so we have a very nice balance here. And  
36 strong performance in the Americas, in our AM business, J2EE part and the result of  
37 our managed service organization. And close to 2800 employees.

---

38 the selling holders during the time the Company agreed to keep its Registration Statement Effective.  
39 Both post-effective amendments were signed by defendants Landan, Smith, Zingale, and Skaer.

1 Quick comment about guidance. For the year we have guided for booking growth of  
2 20 to 25%, revenue growth around 30%, EPS of \$1.50 to \$1.57 **which is around**  
3 **40%**, Op margins 20 to 21% and cash flow from OpEx (ph) growth of 25% to 30%.  
And here you have any number you would ever like to know and with this I would  
ask Doug to join us here and we will be happy to answer questions.

4 74. Defendant Landon's attempts to justify the Company's increased 2005 guidance of  
5 April 28, 2005, on the basis of his beliefs alone, lacked an objective basis and was therefore false  
6 and misleading. Although indicative of an "**unlimited upside**" for the Company's business,  
7 Landon's comments actually served to guide the price of the stock downward, for the following  
8 reasons. First, while Landon pointed to EPS growth of 55% for 1Q05, this claim made no sense  
9 whatsoever, in light of the fact that **1Q05 revenue growth actually decreased \$5.5 million versus**  
10 **4Q04**. Secondly Landon used his incredible assertions to estimate EPS growth for 2005 at **around**  
11 **40%**. Finally, since there analysts were already questioning the "spending environment" faced by  
12 enterprise software vendors, Landon's puffery about "business continuity", "linchpins" and  
13 "innings" could not carry the weight of his incredible numbers.

14 75. Moreover, Landon's statements aided in defendants' continued concealment of the  
15 Company's ongoing internal audit activities in connection with their deficient and defective internal  
16 controls and corporate compliance. By this time, the mere fact that defendants had accumulated  
17 undisclosed audit-related expenses approaching \$1 million was material, even if the potential for  
18 financial restatements was only "highly likely".

19 76. Landon and defendants continued in their active and knowing concealment, while  
20 aware or in conscious and reckless disregard of their liability to shareholders and purchasing holders  
21 of Mercury Interactive convertible notes. In light of this, defendant Landon stuck to his story,  
22 leaving analysts to do the math and conclude that there was no logical reason to accept the false and  
23 misleading guidance and forecasts defendants had provided.

24 77. Then, on June 13, 2005, defendant Landon addressed the Goldman Sachs Bus Tour.  
25 During the event, defendant Landon commented on the mix of business the Company enjoyed from  
26 a geographical standpoint, stating in part:

1 A few words about where we get the businesses from. Still heavily biased towards  
2 the Americas. **Europe is a significant chunk and we have an opportunity to do even**  
3 **more.** (inaudible) Japan and Asia-Pacific is really in its infancy; this number should  
4 be much higher than 10%, but we have a lot of work to do over there, especially in  
5 Japan. **You can see the growth rate, and the non Americas should grow faster in**  
6 **order to gain their fair market (indiscernible) percentage of the business.** Generate  
7 their fair share of the business for us. Overall we have 2,700 people at the end of Q1.

8 \*\*\*

9 I always tend to look first and foremost at the demand equation, and we just happen  
10 to be in a place that on paper the demand equation is extremely unique in every one  
11 of the markets and in the overall opportunity. The challenge for us is to (inaudible)  
12 and to execute. **No gimmes, but (technical difficulty) the demand picture is very**  
13 **very favorable for us I believe for the next quite a few years.**

14 Snapshots of '05, Q1 revenues plus \$200 million, \$0.34, which was 55% (ph) growth.  
15 A record 90 (ph) deals over \$1 million. **And in Q1, which is an indication that we**  
16 **have become more strategic to our customers, we deal with more senior people and**  
17 **they make more strategic bets on our solutions.** The strengths in Q1 were the  
18 Americas' performance, our AM (ph) business, our J2EE, and the results of our  
19 managed service organization.

20 **(inaudible) guidance for the year, booking growth of 20 to 25%; revenue growth of**  
21 **28 to 32%; and (indiscernible) balance sheet. EPS \$1.50 to \$1.57 range. Operating**  
22 **margin 20 to 21%; and cash flow from operation (indiscernible) at 25 to 30%.** If  
23 you have binoculars you can read this slide. (inaudible) slides. Good. So now we can  
24 go into Q&A.

25 \*\*\*

26 78. Defendant Landan again provided his spin on **positive guidance** for 2005 fiscal year,  
27 including revenue growth **approaching a phenomenal 32%**. Moreover, Landan pointed to **non-**  
28 **Americas** growth, with an opportunity to do even more business in Europe. However, when  
29 challenged with specific questions pointing to the general business environment, Landan finally  
30 began to waver, signaling to analysts that they indeed should consider the negative implications of  
31 the changing business environment.

32 79. However, defendant Landon continued to conceal the truth about (i) the Company's  
33 lackluster growth prospects; (ii) the fact that there was no objective basis whatsoever for the  
34 Company's increased 2005 annual guidance; (iii) the continuing active concealment of the  
35 Company's deficient and defective internal controls and corporate compliance, as well as related and  
36 growing auditing costs; and (iv) the fact that the Company would now need to consider restructuring,  
37 as well as costs and charges associated with those downsizing activities.

1 80. Thus, Landon's response to analysts concerned about the general business  
2 environment served to further defendants' concealment, as Landon reached for an answer cleverly  
3 based on *factors such as "seasonality", as well as back-loaded quarters and years, as*  
4 *manifestations of the current business environment:*

5 Unidentified Speaker

6 We will just let everyone ask as we go along. But maybe I would just start by asking  
7 question that everyone (indiscernible). Right now, the June quarter of a year ago  
8 caused a lot of angst for a lot of software companies, actually. In fact, you guys had  
9 great bookings growth in June of a year ago. (inaudible) you looked to the expenses  
10 (ph) and talk about the environment today, what are you seeing from the customers  
11 that you go out and talk to? Are they more upbeat? Do you think you are still very  
12 reticent to spend? Or are they (indiscernible) spending? *Has the environment gotten*  
13 *worse?*

14 Amnon Landan - Mercury Alliances - Chairman and CEO

15 *I am going to give you an answer that would not make any of you happy.* To my  
16 mind, since the end of the nuclear winter around September '03, all conditions are the  
17 same. While there are small fluctuations, they are the same. Because slight  
18 fluctuation might have an impact on companies' performance (indiscernible) quarters  
19 are Q2 of last year, Q1 of this year, where the industry had a real challenging time.  
20 And conversely Q4 of last year or Q (indiscernible) of last year was (indiscernible)  
21 allegedly very robust. The market environment has not changed.

22 In my mind people are very cautious in what they spend. They want to see a much  
23 shorter-term ROI. They need to justify investment. By the way, part of the drivers for  
24 them (indiscernible) governance and demand (inaudible) to justify investments.  
25 Customers are in a more (indiscernible) much stronger position versus the vendors,  
26 compared to the tail (ph) of the bubble. That's life, and I don't think it is good or bad.  
27 That is the way it is, and that is the way I expect it to continue.

28 I don't know that I can -- people invest. Unlike the nuclear winters through '00 till  
29 mid '03, or '01 to mid '03 where it was, keep the lights on and (inaudible). People do  
30 invest in new initiatives because they have to. That is probably the major reason why  
31 they have spent so much money on IT. But they are very, very structured, focused,  
32 and methodical about how they spend a dollar. (inaudible) try to do this within a  
33 salary cap; so they try to (indiscernible) office of the organization into another one.

34 *If you look at the trends, probably I might make a generic statement about the*  
35 *industry, that we see more seasonality. Back-end loaded quarters and years, which*  
36 *again is kind of a manifestation of my biggest (ph) comments about the diligence*  
37 *and (indiscernible) of the customers.*

38 \*\*\*

39 81. Thus, Landan first told analysts that they had reason to expect stellar business  
40 performance from the Company, and then cleverly switched the message, warning of *quarterly and*  
41 *year-end revenue misses, due to "seasonality" and the "back-end loaded" nature of quarters and*

1 years. While the investment community was again left to its own conclusions to decipher Landan's  
2 doublespeak, the market reaction was decidedly negatively. Although Landan was well aware of his  
3 continued concealment of ongoing internal audit activities, significant undisclosed audit-related  
4 expenses, the potential for financial restatements and plans for business restructuring, analysts  
5 remained in the dark about these details. The price of Mercury Interactive's stock, having already  
6 lost nearly 7.6% of its value from its interim high of \$45.88 on May 24, 2005, now accelerated its  
7 downward slide. In the 2 day period immediately following Landan's negative disclosures, the price  
8 of Mercury Interactive stock dropped \$2.34 or 5.5%, to close on June 14, 2005 at \$40.03, on a  
9 combined volume of 7.8 million shares.

10 82. Finally, on July 5, 2005, defendants caused the issuance of a "corrected" press release  
11 entitled, "Mercury Interactive Corporation Reports Preliminary Second Quarter Results". The press  
12 release stated in part:

13 Press Release Source: Mercury Interactive Corporation

14 /CORRECTION -- Mercury Interactive Corporation/

15 Tuesday July 5, 9:03 am ET

16 In the news release, "Mercury Interactive Corporation Reports Preliminary  
17 Second Quarter Results," issued today, July 5, by Mercury Interactive Corporation  
18 over PR Newswire, we are advised by the company that the quote in the second  
19 paragraph should end with the following sentence, "These actions will result in third  
20 quarter restructuring charges."

21 Complete, corrected text follows:

22 Mercury Interactive Corporation Reports Preliminary Second Quarter  
23 Results

24 MOUNTAIN VIEW, Calif., July 5 /PRNewswire-FirstCall/ -- Mercury  
25 Interactive Corporation (Nasdaq: MERQ - News), the global leader in business  
26 technology optimization (BTO), today announced that based on its preliminary  
27 review of its second quarter results, it expects to achieve between \$200.0 million and  
28 \$205.0 million in revenues for the second quarter of 2005, compared to the guidance  
of \$205.0 million to \$215.0 million which Mercury gave in its April 20, 2005 press  
release. Mercury expects that its non-GAAP fully diluted earnings per share for the  
second quarter will be between \$0.30 and \$0.35, compared to the non-GAAP  
earnings per share guidance of \$0.33 to \$0.37 in the April 20, 2005 press release.  
Mercury expects that its change in deferred revenue will be between zero and \$10.0  
million, below the guidance of \$20.0 million to \$30.0 million in the April 20, 2005  
press release. This new range takes into account the expected revaluation of deferred  
revenue due to foreign exchange movements and a shortfall in new orders in the  
second quarter. The April 20, 2005 non-GAAP earnings per share guidance for the

1 second quarter had been adjusted to exclude the following GAAP items: stock based  
2 compensation and amortization of intangible assets related primarily to previous  
3 acquisitions of \$3.9 million. The new non-GAAP earnings per share estimates also  
4 exclude \$16.0 million which Mercury expects to incur in the second quarter for the  
5 write down of certain technology related to a license from Motive, Inc. and certain  
6 other expenses discussed below.

7 "The disappointing second quarter results are due primarily to a shortfall in  
8 Europe," stated Mercury Chairman and Chief Executive Officer Amnon Landan.  
9 "Mercury has a large market opportunity, strong competitive position, and global  
10 customer base. *We have also been engaged over the past several months in a  
11 thorough review of our business operations and are now taking proactive actions  
12 to position us to execute in the second half of 2005. These actions will result in  
13 third quarter restructuring charges.*"

14 *In response to an informal inquiry of the Securities and Exchange  
15 Commission entitled In the Matter of Certain Option Grants, which was initiated  
16 by the SEC in November 2004, the Company's Board of Directors has appointed a  
17 Special Committee consisting of disinterested members of the Audit Committee to  
18 conduct an internal investigation relating to past stock option grants. The Special  
19 Committee is being assisted by independent outside legal counsel and accounting  
20 experts. Mercury continues to fully cooperate with both of these inquiries.*

21 *These inquiries could cause the Company to restate its financial statements  
22 for prior periods. Both the SEC inquiry and the Special Committee investigation  
23 are ongoing. Mercury is unable to determine at this time whether a restatement  
24 will be necessary, and if so, the years affected and the amounts involved. The  
25 Company does not believe that a restatement would have an impact on its historical  
26 revenues, cash position, or non-stock option related operating expenses.*

27 *The Company estimates that it has incurred approximately \$1.0 million of  
28 unanticipated expenses in the second quarter of 2005 for both the Special  
29 Committee investigation and the SEC inquiry, which are excluded in the non-  
30 GAAP earnings per share estimates being provided in this press release.*

31 *The Company assumes no duty to update the information contained in this  
32 press release.*

33 \*\*\*

34 83. The shocking news pointed to previously undisclosed accounting irregularities,  
35 resulting in an internal investigation and auditing process at the Company, a process that had already  
36 incurred *as much as \$1 million in undisclosed expenses*. Moreover, defendants concealed from  
37 investors both the November 2004 SEC inquiry triggering this process and by failing to provide  
38 guidance regarding those costs defendants undertook in response to the inquiry, of the Company's  
39 *Special Committee, independent outside legal counsel and accounting experts*. Moreover, since the  
40 internal investigation and audit was an ongoing process, its costs would reasonably continue to

1 mount, in light of the fact that *the Company remained unable to tell investors which reporting*  
2 *periods would require restatement and the amounts involved.*

3 84. The investment community was now in possession of the reasons behind defendant  
4 Landan's false and misleading presentations of May 16, 2005 and June 13, 2005. Investors now  
5 understood issues at the root of the lowered guidance and negative disclosures, including the  
6 Company's review of its business operations "over the past several months". Although Landan now  
7 explained that the purpose of the undisclosed review was "to position us to execute in the second  
8 half of 2005", a corrected press release was required to disclose the highly material fact that "[t]hese  
9 *actions will result in third quarter restructuring charges*".

10 85. Thus, not only had defendants withheld guidance regarding the cost of its internal  
11 investigation and audit in connection with an SEC inquiry, defendants also withheld highly material  
12 information regarding the desperate state of its business operations, in contrast with defendants' mid-  
13 quarter decision to increase guidance and Landon's dubious and highly transparent affirmation of  
14 that guidance on two subsequent occasions. However, Landon's scheme worked, in that his  
15 disclosures had already caused Mercury Interactive stock to fall as much as \$7.67 or 16.7% from its  
16 interim high of \$45.88 on May 24, 2005. On the news of July 5, 2005, the price of the Company's  
17 stock fell \$0.25, to \$37.96, on volume of 12.2 million shares, nearly six times average volume.

18 86. The almost 17% decline in Mercury Interactive's stock price within the final weeks of  
19 the Class Period was a direct result of the unraveling of the nature and extent of defendants' fraud  
20 finally being revealed to investors and the market. The timing and magnitude of Mercury  
21 Interactive's stock price decline negate any inference that the loss suffered by plaintiff and other  
22 Class members was caused by changed market conditions, macroeconomic or industry factors or  
23 Company-specific facts unrelated to the defendants' fraudulent conduct. During the same period in  
24 which Mercury Interactive's stock price fell almost 17% as a result of defendants' fraud being  
25 revealed, the Standard & Poor's 500 securities index was flat. The economic loss, i.e., damages,  
26 suffered by plaintiff and other members of the Class was a direct result of defendants' fraudulent  
27 scheme to artificially inflate Mercury Interactive's stock price and the subsequent significant decline

28

1 in the value of Mercury Interactive's stock when defendants' prior misrepresentations and other  
2 fraudulent conduct was revealed.

3 87. During the Class Period, defendants knew and concealed that the Company:

4 (a) employed *flawed and defective accounting practices and internal controls*,  
5 particularly those related to compensation issues, including stock options;

6 (b) issued *false and misleading financial statements and guidance*, serving to  
7 conceal the ramifications of *an SEC inquiry* into executive compensation matters;

8 (c) faced financial restatements, over at least a two year period;

9 (d) had issued untrue, false and misleading financial statements in connection  
10 with the resale of the Company's *\$500 million convertible notes offering*;

11 (e) *faced mounting costs for its internal investigation and auditing process* in  
12 connection with the SEC inquiry and restatement;

13 (f) would be *unable to achieve ambitious goals and aggressive guidance for*  
14 *2005*, despite repeated assurances to the contrary; and

15 (g) would need to undertake an evaluation of business operations, including  
16 *restructuring costs necessary to realign the Company's business operations with the market* during  
17 the second half of 2005.

18 **POST-CLASS PERIOD REVELATIONS AND ALLEGATIONS BEARING ON**  
19 **SCIENTER AND/OR MATERIALITY**

20 88. As if to underscore the truth regarding the Company's effective concealment of  
21 adverse business and financial issues from its prior guidance, on July 6, 2005, Forbes published an  
22 article entitled "Department Mercury Interactive Hurt By Aggressive Guidance". The article stated  
23 in part:

24 Credit Suisse First Boston maintained an "outperform" rating on Mercury  
25 Interactive (nasdaq: MERQ - news - people ) after the company warned that fiscal  
26 second-quarter earnings would be weaker than expected. CSFB lowered the stock's  
27 price target to \$44 from \$50. Estimates for 2005 were cut to earnings of \$1.46 per  
28 share on revenue of \$846 million from \$1.54 on revenue of \$883 million. "We do not  
believe there is a 'problem' with end-market demand or the size of Mercury's  
opportunity. Although the second quarter was below our estimates, the company still  
grew bookings between 8% and 16% year-over-year. We believe this miss was  
*caused by aggressive guidance*, a reliance on larger transaction sizes and the double  
whammy of a weaker Europe and a negative F/X impact. Some of the weakness in

1 Europe can be attributed to sales management changes, which can be remedied in the  
2 next few quarters," the research firm said. CSFB now puts bookings growth at 8% to  
3 10%, versus previous guidance of 20% to 25% and lowered its 2005 bookings  
4 revenue estimate to \$880 million from \$984 million. The research firm concluded:  
5 ***"As for guidance, we believe management would be well served by backing out the  
6 contribution from larger deals as the company is still in a transition to a solution  
7 sales organization."***

8 89. Although hesitant to "confirm" their findings, defendants finally spoke of the  
9 materiality of the restatements they now faced, over a period of quarters and years, pointing to  
10 repeated violations of GAAP. On August 8, 2005, defendants published a press release entitled,  
11 "Mercury Interactive Corporation to Delay Filing of Form 10-Q". The press release stated in part:

12 MOUNTAIN VIEW, Calif., Aug. 8 /PRNewswire-FirstCall/ -- Mercury Interactive  
13 Corporation (Nasdaq: MERQ - News), the global leader in business technology  
14 optimization (BTO), today announced that it will not be in a position to timely file its  
15 Form 10-Q for its second quarter ended June 30, 2005, which is due on August 9,  
16 2005.

17 As previously disclosed, Mercury's Board of Directors has established a Special  
18 Committee consisting of disinterested members of the Audit Committee to conduct  
19 an internal investigation relating to past stock option grants. Also as previously  
20 disclosed, the Special Committee has reached a preliminary conclusion that the  
21 actual date of determination for certain past stock option grants differed from the  
22 stated grant date for such awards, which would result in additional charges to  
23 Mercury for stock-based compensation expenses. The Special Committee is  
24 continuing its investigation, and has not yet determined the exact magnitude of the  
25 additional expenses to be incurred or the specific periods affected. Based on the  
26 Special Committee's preliminary determination, ***Mercury believes, but has not yet  
27 concluded that (i) such changes are highly likely to be material and (ii) it is highly  
28 likely that Mercury will need to restate its historic GAAP financial statements.***  
Accordingly, Mercury is not in a position to file its Form 10-Q for the second quarter  
until (1) the Special Committee has reported results of its investigation to the Board  
of Directors, (2) Mercury has reached a final conclusion as to the need to restate its  
financial statements, and (3) all necessary restatements relating to periods covered by  
the Company's presently effective Form 10-K report have been made. Mercury is  
unable to determine at this time when the Special Committee will report on its  
investigation to the Board of Directors.

As previously disclosed, Mercury does not believe that any restatement will have an  
impact on its historical revenues, cash position or non-stock option related operating  
expenses. Mercury intends to complete any required restatements and to file its Form  
10-Q for the second quarter as soon as practicable following the Special Committee's  
report to its Board of Directors.

#### **DEFENDANTS' CLASS PERIOD STOCK SALES**

1           90.     During the Class Period, the following defendants sold their shares in accordance  
2 with the following schedule:

Insider	Title	Shares	Trade Date	Avg. Price	Total
LEBLANC BRYAN	VP, Fin. & Ops.	3000	1/3/2005	\$45.61	\$136,844.70
		1000	2/1/2005	\$43.60	\$43,602.70
		1000	3/1/2005	\$45.92	\$45,918.60
		1000	4/1/2005	\$47.43	\$47,427.80
		1000	5/2/2005	\$41.27	\$41,270.00
		7000			\$315,063.79
MURPHY D. J. III	Sr. VP, Corp Dev	15000	12/9/2004	\$44.22	\$663,352.49
		5000	1/24/2005	\$41.45	\$207,254.01
		5000	2/15/2005	\$47.52	\$237,579.00
		5000	3/15/2005	\$46.36	\$231,798.00
		5000	4/15/2005	\$43.17	\$215,849.99
		5000	5/16/2005	\$41.66	\$208,300.00
		40000			\$1,764,133.49
SCARLAT YUVAL	Sr. VP, Products	70000	12/2/2004	\$46.07	\$3,225,129.14
SKAER SUSAN J	VP, General Counsel	2000	12/1/2004	\$45.31	\$90,620.00
		4000	1/3/2005	\$45.61	\$182,459.59
		2000	2/3/2005	\$47.66	\$95,324.00
		2000	3/1/2005	\$45.94	\$91,872.00
		4000	4/1/2005	\$47.23	\$188,920.39
		2000	5/20/2005	\$45.00	\$90,000.00
		2000	6/1/2005	\$45.00	\$90,000.00
		18000			\$829,195.99
Totals		135000			\$6,133,522.41

**FALSE FINANCIAL STATEMENTS**

18           91.     The financial statements issued by Mercury Interactive during the Class Period and  
19 the statements about them were false and misleading, as such financial information was not prepared  
20 in conformity with GAAP, nor was the financial information a fair presentation of the Company's  
21 operations due to the Company's improper accounting in violation of GAAP and SEC rules.

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

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

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

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

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

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

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

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

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

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

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

13  
14 **APPLICABILITY OF PRESUMPTION OF RELIANCE**

15 **FRAUD-ON-THE-MARKET DOCTRINE**

16 95. At all relevant times, the market for Mercury Interactive securities was an efficient  
17 market for the following reasons, among others:

18 (a) Mercury Interactive's stock met the requirements for listing, and was listed  
19 and actively traded on the NASDAQ, a highly efficient and automated market;

20 (b) As a regulated issuer, Mercury Interactive filed periodic public reports with  
21 the SEC; and

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

26 96. As a result of the foregoing, the market for Mercury Interactive's securities promptly  
27 digested current information regarding Mercury Interactive from all publicly available sources and  
28 reflected such information in Mercury Interactive's stock price. Under these circumstances, all

1 persons who purchased or acquired Mercury Interactive’s securities during the Class Period suffered  
2 similar injury through their purchase of the aforementioned securities at artificially inflated prices  
3 and a presumption of reliance applies.

4 **NO SAFE HARBOR**

5 97. The statutory safe harbor provided for forward-looking statements under certain  
6 circumstances does not apply to any of the allegedly false statements pleaded in this complaint.  
7 Many of the specific statements pleaded herein were not identified as “forward-looking statements”  
8 when made. To the extent there were any forward-looking statements, there were no meaningful  
9 cautionary statements identifying important factors that could cause actual results to differ materially  
10 from those in the purportedly forward-looking statements. Alternatively, to the extent that the  
11 statutory safe harbor does apply to any forward-looking statements pleaded herein, defendants are  
12 liable for those false forward-looking statements because at the time each of those forward-looking  
13 statements was made, the particular speaker knew that the particular forward-looking statement was  
14 false, and/or the forward-looking statement was authorized and/or approved by an executive officer  
15 of Mercury Interactive who knew that those statements were false when made.

16 **CLASS ACTION ALLEGATIONS**

17 98. Plaintiffs bring this action as a class action under Federal Rule of Civil Procedure 23,  
18 on behalf of all persons who purchased or acquired the securities of Mercury Interactive between  
19 October 22, 2003 and July 5, 2005 (the “Class Period”). Excluded from the Class are defendants,  
20 any entity in which a defendant has or had a controlling interest, and members of defendants’  
21 families.

22 99. The members of the Class are so numerous that joinder of all members is  
23 impracticable. The disposition of their claims in a class action will provide substantial benefits to  
24 the parties and the Court. During the Class Period, Mercury Interactive had more than 86 million  
25 shares of stock outstanding, owned by thousands of persons. Record owners and other class  
26 members may be identified from records maintained by Mercury Interactive and/or its transfer  
27 agents and may be notified of the pendency of the action by mail, using a form customarily used in  
28 securities class actions.





1 the wrongful conduct complained of herein. Mercury Interactive controlled each of the Individual  
2 Defendants and all of its employees. By reason of such wrongful conduct, the Individual Defendants  
3 and Mercury Interactive are liable pursuant to §20(a) of the Exchange Act.

4  
5 **PRAYER FOR RELIEF**

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

7 A. Declaring this action to be a class action properly maintained pursuant to Rule 23 of  
8 the Federal Rules of Civil Procedure;

9 B. Awarding plaintiffs and other members of the Class compensatory damages;

10 C. Awarding plaintiffs and members of the Class pre-judgment and post-judgment  
11 interest, as well as reasonable attorneys' fees, expert witness fees, and other costs and disbursements;  
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D. Awarding plaintiffs and other members of the Class such other relief as this Court may deem just and proper under the circumstances.

**JURY DEMAND**

Plaintiffs demand a trial by jury.

DATED: August 25, 2005

SCOTT + SCOTT, LLC  
ARTHUR L. SHINGLER III

/s/ Arthur L. Shingler III  
ARTHUR L. SHINGLER III

401 B Street, Suite 307  
San Diego, CA 92101  
Telephone: 619/233-4565  
619/233-0508 (fax)

-and-  
SCOTT + SCOTT, LLC  
DAVID R. SCOTT  
108 Norwich Avenue  
Colchester, CT 06415  
Telephone: 860/537-3818  
860/537-4432 (fax)

Counsel for Plaintiffs

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I, Arthur L. Shingler III, am the ECF User whose identification and password are being used to file plaintiff's [Corrected] Complaint for Violation of Securities Laws. This document is served consistent with General Order 45.IX.B.

Dated: August 25, 2005

SCOTT + SCOTT, LLC

By: /s/ Arthur L. Shingler III  
Arthur L. Shingler III

Attorneys for Plaintiffs

**CERTIFICATION OF AMS FUND (named Plaintiff)  
PURSUANT TO FEDERAL SECURITIES LAWS**

AMS Fund, Inc., a ("Plaintiff") in the class period, declares, as to the claims asserted under the federal securities laws, that:

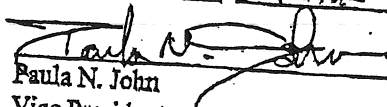
1. Plaintiff and designee outside counsel, Scott + Scott LLC have reviewed the Complaint. AMS Fund, Inc. hereby retains Scott + Scott, LLC and such co-counsel it deems appropriate to associate with to pursue such action on a contingent fee basis. Scott + Scott, LLC has been designated and acts as outside counsel and counsel for securities monitoring/litigation purposes.
2. Plaintiff did not purchase the security Mercury Interactive <sup>MERQ</sup> that is the subject of this action at the direction of Plaintiff's counsel, or in order to participate in any private action. Plaintiff submits this Certification to protect its rights in this litigation.
3. Plaintiff is willing to serve as a representative party on behalf of the class, including providing testimony at deposition and trial, if necessary. Although at this time plaintiff does not intend to move for the position of leadership.
4. The AMS transactions are as follows:

Number of shares	buy/date	price per share
500	11/13/03	49.30
400	11/13/03	49.30
400	11/13/03	49.30
300	11/13/03	49.30
250	11/13/03	49.30

**TOTAL** 1850 shares

5. During the three years prior to the date of this Certification, Plaintiff has never served, nor sought to serve, as a class representative in a federal securities fraud case. Plaintiff has not moved for lead plaintiff in the prior three years. AMS Fund Inc currently serves as a lead plaintiff in the Halliburton Securities Litigation pending in the Federal District Court in Dallas Texas, and is a representative plaintiff in the Enron Securities Litigation. AMS Fund Inc moved for these positions more than three years ago.
6. Plaintiff will not accept any payment for serving as a representative party on behalf of the class beyond the Plaintiff's pro rata share of any recovery, except such reasonable costs and expenses (including lost wages) directly relating to the representation of the class as ordered or approved by the Court.

I declare under penalty of perjury that the foregoing is true and correct. Executed this day 2 of August, 2005, at Dallas Texas

  
Paula N. John  
Vice President  
AMS Fund, Inc.  
Milwaukee, WI